

Annual Report and Accounts 2007

مؤسسة الخليج للإستثمار  
Gulf Investment Corporation



# Mission Statement

Gulf Investment Corporation (GIC) is a leading financial institution offering a comprehensive range of financial services to promote private enterprise and support economic growth in the Gulf Cooperation Council (GCC) region.

To become a 'world-class' organisation, GIC is dedicated to realising its clients objectives, to maximizing shareholder value through earning competitive rates of return, and to the professional development of its people.

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# Board of Directors

## State of Kuwait

**H.E. Dr. Yousef Hamad Al-Ebraheem\***

Chairman  
Advisor to H.H. The Amir of Kuwait

**H.E. Mr. Saleh Mohammed Al Yousef<sup>§</sup>**

## United Arab Emirates

**H.E. Mr. Faisal Ali Al Mansouri\*\***

Manager of Investment Department  
Ministry of Finance & Industry

**H.E. Mr. Saeed Rashid Al Yateem<sup>§</sup>**

Director of Budget Department  
Ministry of Finance & Industry

## Kingdom of Bahrain

**H.E. Dr. Zakaria Ahmed Hejres\***

Deputy Chief Executive  
Economic Development Board

**H.E. Mr. Khalid A. Al-Bassam<sup>§§</sup>**

Chairman  
Bahrain Islamic Bank

## Kingdom of Saudi Arabia

**H.E. Dr. Yahya Bin Abdullah Al-Yahya\***

Economic Consultant  
Saudi Arabian Monetary Agency

**H.E. Mr. Mohammed S. Dobaib<sup>§</sup>**

Acting Director General  
Saudi Industrial Development Fund

## Sultanate of Oman

**H.E. Mr. Darwish bin Ismail bin Ali Al-Bulushi\***

Secretary General  
Ministry of Finance

**H.E. Mr. Abdul Kader Askalan<sup>§</sup>**

Chief Executive Officer  
Oman Arab Bank

## State of Qatar

**H.E. Shaikh Fahad bin Faisal Al-Thani\***

Deputy Governor, Qatar Central Bank

**H.E. Dr. Hussain Ali Al-Abdulla<sup>§</sup>**

Board Member – Executive  
Qatar Investment Authority

## Senior Management

**Mr. Hisham Abdulrazzaq Al-Razuqi**

Chief Executive Officer & General Manager

**Mr. Rashid Bin Rasheed**

Deputy General Manager &  
Head of Finance & Administration

\*\* Chairman of the Executive committee

\* Member of the Executive Committee

§§ Chairman of the Audit Committee

§ Member of the Audit Committee



Total Assets

9.148

US\$ Billion

# Financial Highlights

(US\$ million)	2005	2006	2007
For the year			
Gross Operating and Other Income	330	662	551
Operating Expenses	46	56	52
Net Income	273	600	253
At year end			
Total Assets	7,445	8,113	9,148
Interest Bearing Securities and Funds	4,461	4,746	5,187
Equities and Managed Funds	1,180	1,154	1,387
Projects and Equity Participations	736	1,077	1,078
Deposits	2,061	2,132	2,804
Shareholder's Equity	1,642	1,911	1,958
Selected Ratios (%)			
Profitability			
Return on Paid-up Capital	36.4	80.0	25.8
Return on Adjusted Shareholders' Equity	22.5	42.9	14.9
Capital			
BIS Ratios			
– Total	25.6	25.1	18.6
– Tier 1	22.9	23.9	18.6
Shareholders' Equity as a % of Total Assets	22.1	23.6	21.4
Asset Quality			
Marketable Securites as a % of Total Assets	55.9	53.2	57.1
GCC and OECD Country Risk as a % of Total Assets	99.4	98.3	100.0
Liquidity			
Liquid Assets Ratio	78.6	80.4	81.9
Productivity			
Operating Income as Multiple of Operating Expenses	7.2	9.8	8.6

# Chairman's Statement

On behalf of the Board of Directors, I have the privilege to present the Annual Report and Accounts of Gulf Investment Corporation for the year 2007.

GIC performed well in 2007, a difficult year given the turbulence and volatility in the global financial markets. Net profits for the year reached US\$ 253 million, representing a return on adjusted average shareholders' equity of 14.9% and a return on paid up capital of 26%. Although, lower than the record net income achieved in 2006, the corporation's operating businesses demonstrated resilience in facing the challenges posed.

Operating income, before provisions and non-recurring income, registered a year-on-year growth of 22% to reach US\$ 396 million in 2007. GIC maintained its conservative provisioning policy, allocating approximately US\$ 246 million during the year towards impairment in value of certain assets, adversely impacted by the global credit and liquidity crisis.

With the total capital base reaching US\$ 1,958 million in 2007, GIC continues to be one of the most well capitalized regional financial institutions. Capital represents a key strategic resource which supports the corporation's business activities. In line with its strategic objectives, the corporation will strive to deploy this resource in an efficient and disciplined manner to earn competitive returns. During the year, GIC maintained its phased growth plan, with overall assets reaching US\$ 9.1 billion, a 13% increase over the US\$ 8.1 billion recorded the previous year.

The corporation continued to concentrate on its regional expansion program, focusing on principal investment projects and the capital markets within the GCC countries. Regional project investments during the year grew by 23%, with the aggregate balance exceeding 1 billion in 2007. Additionally, commitments have been made to several new



ventures in a range of sectors. The strong foundation established over the years will enable the corporation to embark on an accelerated growth plan for direct investments in the GCC region. Such principal investments in the region are targeted to double over the next three to five years.

GIC is also keen to contribute towards the development of the regional capital markets, through its expanded asset management and investment banking activities. With our in depth knowledge of the local business environment and strong networking capabilities within the private and public sectors, we are striving to play a key role in the economic development of the region, and simultaneously benefit from it.

The corporation will continue to play a key role in developing the human resource of the region by providing excellent on-the-job training, facilitating transfer of knowledge from our diverse global counterparty pool, and by establishing appropriate training programs for young professionals. In this regard, during 2007, GIC successfully implemented a program for young GCC nationals. It is our objective to introduce and impart international best practice concepts to the regional talent pool.

With its solid capital position, excellent human resource and strong track record, GIC has established itself as a regional leader in its chosen fields of business and is well positioned to take advantage of the opportunities in its operating environments. I see a bright future for GIC.

Since the posts of Chairman and Deputy Chairman of the Gulf Investment Corporation are rotated every two years among the GCC

governments, Mr. Faisal Al-Mansouri, Manager of Revenue Department – Ministry of Finance – UAE, will assume the position of Chairman of the Board following the Corporation's General Assembly meeting in March 2008.

On behalf of the Board of Directors, I would like to extend my appreciation to the Royal Highnesses Kings and Amirs, rulers of the GCC countries for their continuous support, and a special thanks to the State of Kuwait for hosting GIC's Head Quarters and extending all the support needed. I would also like to extend my appreciation to Excellences the Ministers of Finance of the Gulf Cooperation Council for their support.

Finally, I wish to express my appreciation and gratitude to the members of the Board and Executive & Audit committees for their strategic guidance and to the management and staff at GIC for their contributions.

**Dr. Yousef Hamad Al-Ebraheem**

Chairman



# CEO's Review

GIC posted healthy profits for 2007, despite a challenging business environment and volatile global markets. Operating profits before provisions, excluding exceptional non-recurring revenues, reached US\$ 396 million in 2007, a growth of 22% relative to 2006 levels.

Net income for 2007 was US\$ 253 million, representing a return on adjusted average shareholders' equity of 14.9% and a return on paid up capital of 25.8%. Comparatively, in 2006, which was a record year, GIC posted a net income of US\$ 600 million. The year-on-year drop in net income can be attributed primarily to the US\$ 246 million impairment provisions made during the year. Moreover, 2006 profits included a lump sum US\$170 million as gain on exchange of an investment available for sale.

The corporation's sound business model, with an emphasis on diversity of revenue sources, high operating efficiency, dynamic management and prudent risk management helped it to successfully face the challenges posed by the turmoil in the global markets. Despite the significant amount of provisioning, the various businesses contributed US\$ 283 million to GIC's capital base during the year. At the 2007 year end GIC's capital base reached US\$ 1,958 million, with the total capital adequacy ratio, computed as per Basel 2 guidelines, being a solid 18.6%.

During the year businesses grew as planned, with the total assets reaching US\$ 9,148 million at 31st December 2007, a 13% growth compared to the previous year.

The US\$ 246 million set aside during 2007, in line with GIC's conservative and prudent provisioning policy, principally related to the corporation's exposure to structured credit products. The downturn in the global credit markets had an adverse impact on the valuation of these assets, despite a significant portion of underlying assets being of high quality. The corporation's structured credit portfolio includes an array of products, adequately diversified in terms



of managers, geographies and underlying assets. Although, direct US sub-prime component in this portfolio was not significant, the related liquidity crisis and the negative market sentiment contributed to depressed valuations for these assets. Bulk of the provision amount related to such unrealized valuation losses for these assets. The corporation will continue to closely monitor the remaining exposures and take necessary action when required.

#### Projects and Equity Participation

With its portfolio of direct equity investments in the region, GIC is well positioned to take advantage of the regional economic expansion. Over the years the team has built up a high quality portfolio of projects across the GCC region, focusing on strategic sectors while maintaining adequate diversity.

The corporation, through its strong track record and broad network, has evolved as a prominent player and prime mover of key regional projects in sectors such as Petrochemicals, Power, Metals, Financial Services and Telecommunications. As of end 2007, the portfolio included 45 projects with a total balance in excess of US\$ 1,000 million, constituting approximately 12% of the overall assets.

Significant recent achievements include reaching the financial close and starting construction on the power generation and water desalination projects at Shuqaiq and Jubail-Marafiq, two major projects in Saudi Arabia that GIC and partners won the bids to develop. The Jubail-Marafiq project, the world's largest combined power and water plant, has won three prestigious awards including the 'Europe Middle East and Africa Power Deal of the Year 2007'. Al-Ezzel power plant commenced

operations in June 2007. The project, which was co-developed by GIC, accounts for 30% of the generating capacity available to Bahrain's grid. Within the Metal sector, the GIC led Stainless Steel factory in Bahrain commenced operations, while expansion plans to double production capacity of Steel Pellet plant (GIIC) was also initiated.

Other key accomplishments during the year were in the petrochemical, healthcare and telecommunication sectors. These included participation in the capital increase of Crystal to facilitate acquisition of Millennium Inorganic Chemicals Company; investment in the Dubai Wellness Centre based in UAE; and the Tawasul project. Targeting the financial services sector, the corporation is in the advanced stages of establishing a reinsurance company, aiming to cater to substantial regional demand.

The rigor and diligence applied during the pre and post investment phase of these investments have proved extremely beneficial. Over the years contribution from these principal investments to overall profits has increased, a result of continuous monitoring and sound strategic management. It is worth emphasizing that the total value added from these projects is not fully reflected in income statements, as a significant amount of unrealized gains have not been recorded, in line with inter-national accounting standards. Moreover, the intrinsic value of some of these investments is far greater than their book value. Strategies and plans are being developed to unlock this value so that proceeds can be reinvested in other promising sectors.

The corporation will continue playing a leading role as a promoter of investment ideas and themes that enhance and encourage private enterprise within the GCC economies, while providing adequate financial returns to the corporation and our partners.

### Global Markets

The global markets group focuses on GIC's asset management business, both for proprietary investments and third party client accounts. Investment strategies are executed by internal investment teams as well as specialist externally picked managers, with the object of achieving target risk adjusted returns. A wide range of asset classes are covered, including plain vanilla debt instruments, equity investments, international private equity, alternative hedge fund strategies, structured products and derivatives. Treasury activities for the corporation are also managed by this group.

Within GIC's proprietary assets, interest bearing securities continue to form the largest portion, constituting approximately half the balance sheet. This portfolio of high quality bonds generate low-risk, stable spread income, while being a reserve of additional liquidity. Stringent investment guidelines and continuous independent monitoring ensures that required quality is maintained.

Contribution from international private equity funds more than doubled compared to the previous year boosting net income. These funds, managed by specialist external managers, invest in an array of sectors covering different geographies,

participating in leveraged and un-leveraged acquisitions, privatizations and other specialty equity situations.

Revenue from the hedge funds portfolio also rose during the year, providing low risk income while offering benefits of diversification. The alternative investments team continuously monitors this portfolio, and rebalances it according to dynamic global market environment, with the objective of optimizing risk adjusted returns.

GIC had prudently positioned itself to benefit from the robust performance of the regional stock markets. The GCC equity portfolio, managed by a strong team including asset managers and analysts, outperformed benchmarks and posted solid returns. In line with strategic goals, steps are being taken to expand the GCC asset management business, a market whose dynamics our managers comprehend well.

The corporation is establishing new branches in Saudi Arabia & UAE, and a representative office in Qatar, which are expected to be operational during 2008. In addition to being nodal points for the principal investments business, these offices will enhance delivery of our asset management and investment banking services to the regional client base. These new branches will strengthen GIC's presence in the GCC markets and provide a strong basis for business growth, while contributing to the corporation's mission with regard to GCC market and economic development.

Third party asset management activity will continue to be a focus area within the business group, aiming to provide a secure fee based

income source which puts little pressure on capital. 2007 was an excellent year in this regard with client funds under management reaching US\$ 639 million, a growth of approximately 30% compared to the previous year. GIC and the Global Markets group remain ever more committed in building a long term prosperous asset management business built around its regional investment expertise.

Steps have been taken to establish a new Real Estate unit within the group, in order to pursue investment opportunities within the real estate sector, and to enhance the range of products offered to our client base. The corporation proposes to recruit regional and international expertise with a mandate to introduce innovative concepts in real estate management products to the region.

Liability management is a vital component of our business strategy and is handled within our treasury operations. In line with the corporate expansion strategy, steps were taken to issue a 1 billion Malaysian Ringgit note in two tranches of 5 and 15 years. This note will help diversify sources of funding while being stable and long term. The AAA rating assigned to GIC by Rating Agency Malaysia (RAM) is likely to favor the corporation in securing competitive pricing and strengthen its relationships in that region. Moody's, Fitch and Standard & Poor's reaffirmed their ratings as well. We are also making plans to further tap the Islamic finance sector to further enhance the corporation's funding profile.

We will continue to enhance our systems and processes in line with an evolving and dynamic operating environment. Maintaining a sound risk management infrastructure will continue to be an integral part of the corporation's strategic goal. Growth plans and asset allocation strategies will be implemented based on risk adjusted measures, enabling us achieve target returns while maintaining our solid financial strength.

I would like take this opportunity to extend my thanks to our shareholder governments and the board of directors for their support and guidance. I would also like to express my appreciation of the effort and commitment by the GIC staff. Going forward, it is our objective to maintain and enhance the flexibility and adaptability that enabled us to perform well during difficult and changing business environments. I am confident that the strong foundation we have set in place will form an excellent platform for future growth, strength and profitability.

**Mr. Hisham Abdulrazzaq Al-Razzuqi**  
CEO and General Manager

# Economic Review





The year which started on an optimistic and high note, has witnessed one of the most serious financial crisis of the recent decades: the collapse of the US subprime mortgage lending market and the consequent deterioration in the credit markets by a significant drying up of liquidity. The regional markets, however, witnessed one of their better years. Equities performed admirably after the drastic corrections that were suffered in 2006, and high oil prices coupled with investor optimism regarding the region's prospects have led to a boom in mega project investments and business expansion.

## **World Economies and Markets**

The most serious challenge to financial stability and world economic growth in the year was the subprime crisis that started to appear in the US during the summer months. Markets noticed an increase in the default rates of subprime mortgage borrowers. The initial reactions - in June - were that such a problem is limited to a small sector of mortgage lending and that its ramifications will be handled properly by market participants. This, however, was not the case and as such, the subprime paper became the culprit in one of the major financial crises facing the world economy in recent decades.

Table I: Main Economic Indications for Major Economies, (%Change)

Country	Gross Domestic Product			Inflation			Unemployment* (%)		
	2006	2007 <sup>e</sup>	2008 <sup>f</sup>	2006	2007 <sup>e</sup>	2008 <sup>f</sup>	2006	2007 <sup>e</sup>	2008 <sup>f</sup>
United States	2.9	2.2	1.4**	3.2	2.9	3.4	4.6	4.6	5.3
Japan	2.4	2.0	1.3	0.2	0.0	0.6	4.1	3.9	3.8
Germany	2.9	2.5	1.7	1.6	2.3	2.3	10.8	9.0	8.1
France	2.2	1.9	1.6	1.6	1.5	2.3	9.2	8.3	7.8
United Kingdom	2.9	3.1	1.7	2.3	2.3	2.5	2.9	2.7	2.8
Euro Zone	2.9	2.6	1.5	2.2	2.1	2.7	8.3	7.4	7.1
China	11.1	11.4	10.2	1.5	4.8	5.0	n.a.	n.a.	n.a.
India	9.6	8.6	8.0	6.7	5.9	5.8	n.a.	n.a.	n.a.

Figures for 2006 are actuals.

e Estimate.

f Forecast.

\* Year Average.

\*\* Morgan Stanley forecast: 1.1%; Merrill Lynch: 0.8%.

Sources: - Consensus Economics Inc: Consensus Forecast, March 2008.

- Consensus Economics Inc: Asia Pacific Consensus Forecasts, March 2008.

It is important to note that many participants played a role in the crisis: the large banks that developed subprime products, securitized them and sold them to investors (including hedge funds), the rating agencies which gave high ratings to complex products that included subprime papers, and risk management professionals who approved investments in products whose risk they did not properly assess or understand. The subprime crisis magnified the housing crisis that started in 2006 when house prices in the US started a downward trend and also when more houses were unsold and inventories increased to levels not seen in a decade.

By the third quarter of the year, the crisis, emanating from the subprime debacle, started to take a serious tone when large banks (Merrill Lynch, UBS, Deutsche Bank, Bear Stearns and Morgan Stanley) announced losses in billions of dollars. The estimate of losses by banks coming from the subprime crisis during 3Q and 4Q of 2007 is around \$90-\$100 billion.

As a result of bank losses, a credit crunch started taking shape when banks limited credit creation in order to maintain regulatory requirements of capital to loans. Banks also started seeking capital support from wealthy investors, particularly from those emerging markets with strong surpluses (GCC Sovereign Wealth Funds, China, Singapore, ...etc.).

What started as a subprime mortgage lending crisis became not only a credit crisis but also a liquidity crisis because risk aversion increased on all sides (lenders, investors, and all kinds of financial intermediaries). By the end of the year, the recognition that the US and other developed markets in Europe were facing a financial crisis became clear. And the actions by the US Federal Reserve to cut interest rates in order to support markets was not working. Also, actions by central banks in the US and Europe to supply liquidity through loan auctions to banks was not very effective and the libor rates continued to be higher than the overnight Fed Funds rates determined by the Federal Open Market Committee (FOMC).

The implications of this financial crisis for economic growth and consumer confidence were felt by markets all over the developed world. Although US GDP growth in 3Q 2007 came strong (at 4.9%), the expectation of economists for 4Q growth was estimated around 1% or lower. Many large investment banks (Morgan Stanley and Goldman Sachs, predicted a shallow US recession in the coming year (See Table I).

As a result of the rather bleak picture of major markets in the second half of the year, we find that equities – which did well until 3Q – slid going into the year end. Table II shows Global Equity Indices for the year and although all markets were positive (except Japan), they were noticeably below their highs for the year.



Table II: Globe Equity Indices for 2007 (in local currencies)

Index	29 Dec. 06	31 Dec. 07	% Change	High 2007	Low 2007
<b>North America</b>					
DJIA	12,463.15	13,264.82	6.43%	14,164.53 9 Oct	12,050.41 5 Mar
S&P 500	1,418.30	1,468.36	3.53%	1,565.15 9 Oct	1,374.12 5 Mar
NASDAQ Composite	2,415.29	2,652.28	9.81%	2,859.12 31 Oct	2,340.68 5 Mar
Russell 2000	787.66	766.03	-2.75%	855.77 13 July	735.07 26 Nov
DJ Wilshire 5000	51.15	54.01	5.61%	57.39 9 Oct	49.94 5 Mar
DJ Wilshire Global Total Market	2,830.97	3,101.60	9.56%	3,295.01 1 Nov	2,755.76 5 Mar
<b>Europe</b>					
FTSE 100	6,220.80	6,456.90	3.80%	6,732.40 15 June	5,858.90 16 Aug
Xetra Dax	6,596.92 *	8,067.32	22.29%	8,105.69 16 July	6,447.70 14 Mar
CAC 40	5,541.76	5,614.08	1.31%	6,168.15 1 June	5,265.47 16 Aug
<b>Asia</b>					
Nikkei 225	17,225.83 *	15,307.78		18,261.98 9 July	14,837.66 21 Nov
Hang Seng	19,964.72	27,812.65	39.31%	31,638.22 30 Oct	18,664.88 5 Mar

\* Year-end as of 28th December 2007

Source: Bloomberg

The bond markets exhibited a typical case of flight to safety with 10-Year treasuries yielding 4.03% at year end, and actually going all the way to 3.84% on 26th November 2007.

The corporate bond index of Merrill Lynch (Table III) shows clearly the risk aversion. High yield, which returned 11.68% in 2006 came at 1.56% in 2007, while the total return on US 10-year treasuries (Table IV) was 10.1% in 2007 compared with 1.8% in the previous year.

Table III: Merrill Lynch Globe Bond Market Returns (Year-end)

	2007	2006	2005
Corporate Index	2.62%	2.64%	3.19%
High Yield Index	1.56%	11.68%	3.15%

Source: Bloomberg

Table IV: US Treasury Bill 10 Years Total Returns (Year-end)

	2007	2006	2005
Bloomberg	10.1%	1.8%	6.3%

Source: Bloomberg

Commodities continued to enjoy a strong year due to large demand from high growth Asian economies (in China and India) and also due to supply limitations. Commodity investors enjoyed 22.8% return in 2007 after a strong year in 2006 (16.46%).

### Oil Markets

Because GCC economies are very much influenced by world oil markets and prices, we focus, on this sector of the commodities market in some detail.

Table V shows average oil prices for the three main crude oil benchmarks (WTI, Brent and the OPEC basket). All of them increased in 2007 by a noticeable margin over the previous year (>10%). Indeed, oil prices finished the year on record levels as shown in Table VI. WTI reached a high of a shade below \$100 on 20 November, Brent was \$95.81 on 23 November and OPEC basket was \$91.91 on 21 November.

Table V: Spot Crude Prices - Yearly Average (US\$/bl)

	OPEC Basket		Brent		WTI	
	Avg	Y/Y % change	Avg	Y/Y % change	Avg	Y/Y % change
Year 2007	69.10	13.1%	72.55	11.3%	72.29	9.5%
Year 2006	61.08	20.6%	65.16	19.7%	66.04	16.9%
Year 2005	50.64	40.5%	54.44	42.4%	56.51	36.4%
Year 2004	36.05	28.3%	38.23	32.7%	41.44	33.3%
Year 2003	28.10	15.4%	28.81	15.1%	31.09	19.0%
Year 2002	24.36	5.4%	25.03	2.3%	26.13	0.5%

Source: MEES, 14 January 2008 and various issues.

Table VI: Spot Crude Prices for 2007, (US\$ per bl)

	High 2007	Low 2007	Annual % Change	31 December 2007	29 December 2006
Brent Crude	95.81 on 23 Nov.	51.31 on 16 Jan.	56.14%	93.89	60.14
West Texas Intermediate	99.88 on 20 Nov.	50.48 on 18 Jan.	57.25%	96.00*	61.05
OPEC Basket <sup>®</sup>	91.91 on 21 Nov.	47.92 on 17 Jan.	62.36%	90.92*	56.00
Natural Gas Henry Hub (US\$/mmbtu)	9.07 on 5 Feb.	5.29 on 4 Sep.	30.18%	7.16*	5.50

\* As of 28<sup>th</sup> December 2007.

<sup>®</sup> It is an average of the following crudest: Saharan Blend (Algeria), Minas (Indonesia), Iran Heavy (Islamic Republic of Iran), Basra Light (Iraq), Kuwait Export (Kuwait), Es Sider (Libya), Bonny Light (Nigeria), Qatar Marine (Qatar), Arab Light (Saudi Arabia), Murban (UAE) and BCF 17 (Venezuela).

Source: Bloomberg

All indications are that the world would have to deal with a very slow supply increments versus an increasing demand. Supply hurdles (technical, geopolitical, weather-related...etc.) affect prices in a noticeable manner.

The year also saw the dollar's further slide against all major currencies (Table VII). The continued slide in the dollar value affected the GCC economies with pegged currencies to the dollar (all except Kuwaiti Dinar which became linked to a basket of currencies on 20 May 2007). However, it had positive impact on US current account deficit, which was at \$ 738.6 billion in 2007, 9% lower than the all time high deficit of \$ 811.5 billion recorded in 2006.

Table VII: FX Rates (Year-end)

	YTD % Change (against the US\$)	31 December 2007	29 December 2006
Euro	+11.75%	\$1.4717	\$1.3170
Pound	+2.27%	\$2.0064	\$1.9619
Yen	+6.18%	111.71 per dollar	119.07 per dollar

Source: Bloomberg

## The GCC Economies

Unlike the darkening picture in international markets, especially in the second half of the year, the GCC economies continued to enjoy a boom in 2007. The main drivers for the boom were:

1. Strong oil prices that are expected to continue.
2. An investment boom, in different sectors of the economy.
3. Improved institutional and regulatory systems that deal with economic and financial markets.
4. Continuous efforts by the GCC authorities to increase the level of integration and cooperation among the various countries.
5. Announced policies for the liberalization of trade and opening up to international investors. This is signified in more free trade agreements and the gradual opening of the financial sector and the stock markets to external investors.

Most of these fundamentals are reflected in the levels of GDP growth (Table VIII), driven by an increase in oil income (Table IX), but are also reflected in higher rates of inflation (Table X).

Table VIII: GCC Real GDP Growth for 2003 – 2007 (Annual % change)

	Actual					Estimate	
	2003	2004	2005	2006		2007	
				Real GDP (% change)	Nominal (bn US\$)	IMF	IIF
Bahrain	7.2	5.6	7.8	7.6	15.8	6.8	6.3
Kuwait	16.5	10.5	10.0	5.0	101.9	3.5	5.1
Oman	2.0	5.4	5.8	5.9	35.7	6.0	6.5
Qatar	6.3	17.7	9.2	10.3	52.7	14.2	8.3
Saudi Arabia*	7.7	5.3	6.1	4.3	349.1	4.1	3.1
United Arab Emirates	11.9	9.7	8.2	9.4	163.2	7.7	7.5

Sources:

- IMF, World Economic Outlook, October 2007.
- IIF, GCC Country Reports, 2007.
- GIC, GCC Economic Statistics Report, 7<sup>th</sup> edition 2007.

\* As per Consensus Forecasts, January 2008, the GDP/Growth Rate estimate for Saudi Arabia in 2007 reads as 4.2 and for 2008 as 5.1.

Table IX: GCC Oil Exports Revenues, (US\$ billion)

	2001	2002	2003	2004	2005	2006	2007 <sup>e</sup>	2008 <sup>f</sup>
Bahrain	3.7	4.0	4.7	5.6	7.8	9.2	9.1	9.2
Kuwait	15.0	14.1	19.6	27.8	44.1	55.7	55.9	57.7
Oman	8.9	8.6	9.3	10.9	15.7	17.5	17.7	20.7
Qatar	9.9	9.1	12.2	16.2	22.9	28.8	32.5	42.3
Saudi Arabia	59.8	63.8	82.3	110.8	162.4	188.6	188.4	212.4
United Arab Emirates	23.1	23.2	29.6	38.4	55.1	70.1	74.9	80.2
GCC	120.4	122.8	157.6	209.6	308.0	369.9	378.5	422.5

e: IIF estimates.

f: IIF forecasts.

Source: The Institute of International Finance Data Base ([www.iif.com](http://www.iif.com)), Aug. 2007.

Table X: Consumer Price Index for GCC Countries, (Annual % change)

	2005		2006		2007 <sup>e</sup>	
	IMF	IIF	IMF	IIF	IMF	IIF
Bahrain	2.6	2.6	2.9	2.1	2.9	3.3
Kuwait	4.1	4.1	2.8	3.1	2.6	4.5
Oman	1.9	2.0	3.2	3.0	3.8	3.8
Qatar	8.8	8.8	11.8	11.8	12.0	9.5
Saudi Arabia	0.7	0.7	2.2	2.3	3.0	3.7
United Arab Emirates	6.2	6.2	9.3	9.3	8.0	9.8

e: Estimates.

Sources: IMF, World Economic Outlook, October 2007, and the Institute of International Finance Data Base ([www.iif.com](http://www.iif.com)), Aug. 2007.

In the following section we review sectoral developments in the various economies of the region during the year in order to round up a more concrete picture of what has been taking place.

## Sector Developments

Sector development process has focused mainly on mega infrastructure projects such as power, water desalination, ports development. Most of these projects are underway through public/private partnerships. Other forms of participation include joint ventures, outsourcing and IPO offerings. The demand for infrastructure projects has been growing at a greater magnitude in GCC countries and in particular Saudi Arabia and the UAE due to the relative diversification of both economies. In Saudi Arabia (the largest GCC economy by far), the demand for water is expected to increase from 6mn cubic meters/day in 2004 to 7.2mn in 2010; as a result, the government had allocated \$4.4bn in the 2007 budget to water projects.

## Public Utilities, Infrastructure

Power and Water projects have been the milestone projects during the year 2007 to meet the region's growing consumption at an average rate of 9% annually. The GCC Interconnection Authority announced that the \$1.1bn first phase of the GCC power grid is on target with more than 30% of the phase completed by mid 2007. While this phase called the GCC North Grid which connects **Kuwait, Saudi Arabia, Bahrain, and Qatar**, the second phase is called the South Grid and will connect **UAE and Oman**. Upon completion of the Grid, it will have an interconnection capacity of 1,200 MW available to each of Kuwait and Saudi Arabia, and 900 MW to the UAE, 750 MW to Qatar, 600 MW to Bahrain and 400 MW to Oman.

In the **UAE**, Abu Dhabi Water and Electricity Authority (ADWEA) signed a 20 year BOO contract to develop its seventh IWPP, Fujairah-2, for a total cost of \$2.8bn. Dubai Water and Electricity Authority (DWEA) awarded a \$1.1bn contract to build a thermal power plant in Jebel Ali with capacity to produce 2,000mw of power and 105mn gallons/day of desalinated water. Both projects are expected to be completed by 2010.

In **Saudi Arabia**, Water and Electricity Company (WEC) started the bidding process for Raz Azzour Independent Water and Power Project (IWPP), the third project in WEC program after Shuaibah IWPP and Shuqaiq IWPP\*. Ras Azzour IWPP will have a desalination capacity of 1 million cubic meters per day and power capacity of 850 - 1,100 MW. The Power and Water Utility Company for Jubail and Yanbu (Marafiq) launched the Yanbu IWPP with a capacity of 150,000 cubic meters per day of water and 1,700 MW of power. This will be the second project in the Marafiq IWPP program after the successful implementation of the Jubail IWPP\*\*, the largest of its kind in the world with 800,000 cubic meters per day of water and 2,750 MW of power.

In the eastern region of **Oman**, France's Veolia Water announced that along with its local



partner Suhail Bahwan Group, it won a 22-year BOO contract worth Euro 111 million for the Sur desalination plant with a capacity of 80,200 cubic meters per day.

**Bahrain** plans to increase its power and water capacity by 4,000 MW and 410,000 cubic meters per day, respectively. It announced the launch of its third independent project, Al Dur IWPP, with a capacity of 1,100 - 1,250 MW and 218,000 cubic meters per day. Al-Ezzel IPP\*\*\*, the Kingdom's first independent project with a capacity of 950 MW and a total cost of \$500mn, was inaugurated during the year.

## Construction

**Saudi Arabia** has announced three new economic cities in the northwest and the eastern provinces, and in Tabuk. The number of announced economic cities in the Kingdom stands at seven, given the previously established ones in Madinah, Rabigh, Hail, and Jizan. According to announced plans, these economic cities are expected to contribute \$150bn to GDP by 2020, accommodating different industries such as steel, plastic, and ceramic. **Qatar and Bahrain** signed a MOU for the construction of the proposed 40km causeway to link both States by 2011 with total cost projected at \$3bn. In the **UAE**, Dubai's government has launched \$1.4bn aviation city as part of Dubai World Central to incorporate, in addition to the city and the airport, the world's largest maintenance and repair centre. New airport capacities were announced in **Qatar, Saudi Arabia, UAE, and Bahrain** as well.

\* GIC has an equity stake in the Shuqaiq IWPP which it co-developed with ACWA Power Projects and Mitsubishi Corp.

\*\* GIC has an equity stake in the Jubail IWPP which it co-developed with Suez Group and ACWA Power Projects.

\*\*\* GIC has an equity stake in Al-Ezzel IPP which it co-developed with Suez Group.

## Oil and Gas, Aluminum and Petrochemicals

Many Engineering, Procurement, and Construction (EPC) contracts have been awarded this year in the GCC region. Two notable EPC contracts include Kayan Petrochemical Company: 40,000ty Phenolics and 260,000ty Polycarbonate plants. These two plants are located in the company's planned petrochemical complex in Jubail which is expected to cost around \$10bn. The complex will include a polypropylene plant, a 2mnty ethane cracker, a 700,000ty polyethylene plant, and a 530,000ty ethylene glycol unit as well. Abu Dhabi Oil Refining Company (Takreer) has signed an EPC contract worth \$272mn to implement the sulfur handling expansion project at Ruwais which is expected to be completed by 2009. Borouge, has signed a \$1.3bn EPC contract for the construction of a 1.5mnty ethylene cracker in Abu Dhabi. Oman Oil Company has signed EPC contract for its \$900mn Salalah Methanol Company's production facility in Salalah Free Zone. Maersk Oil Qatar has signed EPIC contract for developing Al-Shaheen oilfield.

GCC countries, mainly **Saudi Arabia** and the **UAE**, have continued to explore overseas investments in refinery and petrochemical companies. **Saudi Arabia's** petrochemical production is expected to reach 100mnty by 2015, growing at an annual rate of 12%. The country aims at increasing the number of its petrochemical products from 40 in 2007 to 120 in 2012 according to the 2005-2012 investment plan. Aramco had been given a formal approval for its two joint ventures in Fujian Province jointly with ExxonMobil, and two Chinese petrochemical companies. The Aramco's two joint ventures worth \$9bn are China's first fully integrated refining, petrochemicals and fuels marketing projects with foreign participation. Saudi Basic Industries Corporation (SABIC) had a 70-30 Polystyrene joint venture with Turkey's Baser

Petrokemya. The venture includes a 40,000ty plant worth \$22mn. SABIC also got the EU approval for its acquisition of Huntsman's European Base Chemicals and Polymers business with 865,000ty ethylene unit, 400,000ty propylene cracker, and a 1.3mnty aromatics facility.

In the **UAE**, Abu Dhabi's International Petroleum Investment Company acquired 20% stake in Japan refiner Cosmo Oil for \$776mn with total refining capacity of 635,000b/d. Abu Dhabi National Energy Company (TAQA) has acquired Canada's Prime West Energy for \$5bn. Dubai-based Stellar Group is a subsidiary of the joint venture providing EPC services for cooling facilities in **UAE** and **Saudi Arabia**. Dana Gas has completed its acquisition of Canada's Centurion Energy for \$950mn, which is engaged in gas exploration and production operations in Egypt, Tunisia, and West Africa. Mubadala Development Company and Dubai Aluminuim (Dubal) established a private company to build and finance aluminum smelters both within and outside the **UAE**. This includes the development of Al Taweela \$6bn complex in Abu Dhabi which by 2010, will be considered the largest Greenfield aluminum smelter in the world with total capacity of 1.4mnty and will include 2,600mw power station. Abu Dhabi's government plans to build a \$350mn solar power plant, the first of its kind in the GCC, with total capacity of 500mw, to become operative by 2009. The plant is part of Abu Dhabi's drive to cut dependence on hydrocarbon power generation. Dubai announced it had entered a strategic joint venture to develop and operate the \$3bn Sangaredi refinery project in Guinea along with BHP Billiton, Canada's Global Alumina International and Abu Dhabi's Mubadala. Guinea holds around a third of the world's bauxite reserves and will ensure Dubal access to low cost alumina. The project will have the capacity to produce 3mnty of alumina as well as developing a 9mnty bauxite mine. Ma'aden signed a joint venture with Alcan to develop a proposed \$7bn integrated Aluminum project including bauxite mining, alumina refining, power generation and aluminum smelting. The project should enjoy one of the lowest operating costs in the industry and could become one of the world's largest smelters. India's Darvesh Group announced plans to establish a \$545mn aluminum processing in Dubai Industrial City with initial production capacity of 30,000ty in early 2008. The plant will process ingots sourced from regional smelters including Dubal and manufacture end-user products and its production capacity should reach 135,000ty by 2010. In **Kuwait**, Gulf CO2 Company (a privately owned company), was established to help preserve the environment by collecting carbon







dioxide that comes from power and desalination plants as well as from refineries then injecting it in oil fields to boost productive capacity.

**Bahrain** is moving to privatize gas stations and is using a specialized firm to conduct studies into how the privatization process would be carried out. In **Kuwait** a gradual privatization program of gas stations is underway. Abu Dhabi National Oil Company (ADNOC) signed a MOU with Japan Bank for International Cooperation (JBIC) to establish a comprehensive partnership for business development in the oil and gas sector. This would facilitate a stable energy supply to Japan while ADNOC will benefit from JBIC's financial muscle.

## Manufacturing

In **Saudi Arabia**, National Titanium Dioxide Company (Cristal)\*, has signed a deal to buy US company Lyondell's inorganic chemicals business, the world's second-largest producer of titanium dioxide with an annual capacity of 670,000 tons. While Cristal is the world's ninth-largest titanium dioxide producer it is the only one based in the Middle East, with a current production capacity of 100,000ty, and a designed production capacity of 180,000ty. The deal is part of the growing trend by Gulf companies to invest outside the region, which has included Saudi Basic Industries Corporation's (SABIC) \$11.8bn purchase of General Electric's plastics division. Also the **Kingdom of Saudi Arabia** intends to privatize the second Phase of Jubail-2 within Jubail industrial city. The first phase of Jubail-2 was completed at a cost of \$2.7bn and is

expected to attract \$19.2bn worth of investment; the second and the third phases, to be completed by 2022, are expected to attract investments worth \$64bn. Sipchem's acetyls complex in Jubail has chosen Fluor Corporation to provide Engineering, Procurement, and Construction (EPC) contract worth \$1bn to manufacture acetic acid and vinyl acetate monomer, a high-end specialty plastic. Construction began in May 2007 and completion is targeted for December 2008. The lead developer of Hail Economic City, Rakisa Holding Company, has signed a MOU with BNP Paribas and BMG Financial Advisors for the establishment of a SR1.5bn (\$400mn) venture North Mining Company to focus on boosting mining activities in the northern area of the Kingdom.

**UAE** Shadeed Iron and Steel signed a MOU with India's Jindal Saw Int., to set up a \$4bn Steel plant in Sohar Industrial Port of Oman. The plant will produce 1mnty of seamless tubes and commercial production is expected in the third quarter of 2008. Borouge, a subsidiary of (ADNOC), announced plans to develop plastics compounding facility in China for the manufacture of high performance polypropylene compounds for applications in the automotive and electrical appliance sectors. The facility will be constructed in the Shanghai area and will have a capacity of up to 50,000 tons/year with further expansion possible. It will be strategically located to take advantage of the supply of polypropylene from its production plant in Ruwais, Abu Dhabi, through an advanced logistics concept and to serve current customers such as VW, GM and PSA in China and cater to other potential customers.

\* Cristal is owned by Gulf Investment Corporation.

### Financial Services and the Banking Sector

National Bank of Kuwait has approved 20% capital increase through a rights issue to help the bank meet its strategic regional expansion through 40% acquisition of Turkish bank as well as 94% acquisition of Al Watany Bank of Egypt. The government of Dubai created the Gulf's biggest bank in terms of total assets when it approved a \$11.3bn merger deal between Emirates Bank Group and National Bank of Dubai. The newly formed bank will have total assets worth \$40.6bn. A new bank (Crescent Bank) was established in the **UAE** with \$1.1bn initial capital, owned by Abu Dhabi Investment Council, to comply with Shari'a Law and cater for the private sector. **Qatar** and the **UAE** signed an agreement to set up a joint venture investment company with \$1bn capital to target investment opportunities in the MENA region. Qatar National Bank (QNB) signed an agreement to set up a new joint venture bank in Syria with base capital worth \$100mn. QNB will own 49% of the new bank and the remaining

51% will be owned by Syrians. Also, Kuwaiti and Syrian investors have established the first Syrian Islamic Bank, capitalized at \$100mn. Qatar Islamic Bank signed a MOU with Sudan's Central Bank to establish a commercial investment bank in Sudan complying with Shari'a Law with authorized capital \$1bn. In **Bahrain** the government will establish a single financial regulatory authority to oversee banking, insurance, securities, and other financial services to ensure the compliance with international standards. Standard & Poor's has launched new five indices for GCC countries in response to their growing demand for Islamic modes of financing. The Dow Jones together with Dubai Financial Market (DFM) has launched the Dow Jones DFM Index and Dow Jones DFM Titans 10 Index as part of Dow Jones Islamic Market Index series. Both indices cater for investment products and track the performance of equities on the DFM with regards to compliance with Shari'a Law.

With respect to sources of financing, the MENA and GCC regions witnessed marked growth in 2006 and 2007 in the number of Private Equity (PE) funds as well as other sources of financing such as IPO offerings and Islamic bonds (Sukuk) to meet the demands of expanding businesses in the region.

The number of Initial Public Offerings (IPOs) have increased in 2007, in **Saudi Arabia** alone it reached 26 compared to 10 IPOs in 2006. Considerable growth in liquidity continued to be the engine for IPO growth in the GCC region where IPO deals managed to absorb a total of \$12bn in 2007, a 60.5% increase over 2006. As a result, the number of IPOs across the Middle East has increased from 47 IPOs in 2006 to 66 IPOs in 2007 and is expected to reach more than 100 IPOs in 2008. The financial services sector continued to see the largest number of IPOs within the GCC region with 21 offerings in 2007 compared to 7 offerings in 2006.



Table XI: Successful IPO Offerings in the GCC Region in 2007

Company Name	Country	Value (US\$m)
DP World	UAE	4,963
Saudi Kayan Petrochemical Company	Saudi Arabia	1,800
Dar Al Arkan Real Estate	Saudi Arabia	893
Deyaar Development Company	UAE	883
Kingdom Holding Company	Saudi Arabia	861
Air Arabia	UAE	713
Jabal Omar Development Company	Saudi Arabia	537
Al Khalij Commercial Bank	Qatar	338
Galfar Engineering and Contracting	Oman	156
Middle East Specialized Cables Company	Saudi Arabia	118
Saudi Printing and Packaging Company	Saudi Arabia	106

Source: Zawya.com

This strong demand for IPOs reflects strong economic fundamentals in the region coupled with investor confidence regarding the future.

With respect to Private Equity (PE), the most prominent PE funds for 2006 and 2007 are mentioned below.

Table XII: Most Prominent PE Funds in 2006 and 2007 (US\$ bn)

2006		2007	
PE Funds	Value	PE Funds	Value
Infrastructure and Growth Capital Fund	2.00	Dubai Islamic Bank and Dubai Ports World	3.00
Global Energy Fund	1.00	Global Investment House	1.50
Global Opportunistic Fund	1.00	EMP Energy Fund	1.00
The Technology Fund	1.00	Gulf Opportunity Fund	1.00
Growth Gate Fund	0.50	Al Dar PE Fund	0.50
Gulf Capital	0.30	Al Futtaim Real Estate Development Fund	0.50
Ithmar Fund	0.25	Bunyah GCC Infrastructure Fund	0.40
NBK Capital Equity Partners	0.25	HBG Investment Holdings	0.10

Source: Zawya.com

With respect to Islamic bonds (Sukuks), the total size of Islamic bonds (Sukuk) issues in the GCC region has increased by 68.3% from \$11.4bn in 2006 to \$19.2bn in 2007. The rise in the issuance of Sukuk has increased by 11 from 39 (15 corporate and 24 sovereign) in 2006 to 50 (25 Corporate and 25 Sovereign) in 2007. The **UAE** and **Saudi Arabia** had 34% and 17.5% share of global sukuk corporate issuing, respectively, during the year. While financial services and government sectors captured most of the issues in 2006, the two sectors continued the same trend in 2007 together with the real estate sector.

Table XIII: Islamic Bonds (Sukuks) issues in the GCC in 2006 and 2007

Country	2006		2007	
	Corporate No. of Issues/ Value	Sovereign No. of Issues/ Value	Corporate No. of Issues/ Value	Sovereign No. of Issues/ Value
UAE	7 \$8.8bn	-	12 \$11.1bn	-
Saudi Arabia	2 \$822mn	-	5 \$5.7bn	-
Bahrain	-	24 \$799mn	3 \$460mn	25 \$607mn
Kuwait	5 \$750mn	-	4 \$835mn	-
Qatar	1 \$270mn	-	1 \$300mn	-

Source: Zawya.com

Table XIV: Major GCC Corporate Islamic Bonds (Sukuks) Issued in 2007

Company Name	Country	Value (Bn US\$)
Al Dar Funding Limited with Musharaka Financing	UAE	2.53
Saudi Basic Industries with Ijarah Financing	Saudi Arabia	2.13
Jebel Ali Free Zone with Musharaka Financing	UAE	2.04
Dar Al Arkan Real Estate Development Company with Ijarah Financing	Saudi Arabia	1.60
DP World Sukuk Limited with Modarabah Financing	UAE	1.50
Saudi Electricity Company with Ijarah Financing	Saudi Arabia	1.33
Dubai IFC with Modarabah Financing	UAE	1.25
Dubai Electricity and Water Financing with Ijarah Financing	UAE	1.00
Dana Gas with Modarabah Financing	UAE	1.00
DIB Sukuk Company with Musharaka Financing	UAE	0.75

Source: Zawya.com

This sectoral review indicates an increasing level of economic activity and business confidence that the region has been experiencing since 2003. With solid economic fundamentals, the region's economies can look forward to a positive path.

## GCC Stock Markets

### Overview

During 2007, the GCC markets succeeded in putting the tumultuous downturn of 2006 behind them, as all markets closed the year with robust gains. The rise was supported by an upturn in trading volumes, and did not appear to suffer much from the large public offerings that siphoned off liquidity out of the system at periodic intervals during the year.

Better corporate earnings and an improvement in disclosure by listed companies helped to boost investor sentiment. Institutional and retail participation improved, with a higher inflow of foreign capital into the regional markets. Quality of earnings showed a significant improvement, with frontline stocks showing marked growth in core earnings, and declining reliance on investment and one-off returns to boost profits.

The GIC Composite Index closed the year at 7,379.52, having gained 42.4% during the year. This contrasts sharply with the negative returns of 43.09% for 2006, and brings the long-term performance of the GCC on track to outpace the international and emerging market indices. The GIC Composite Index outperformed the MSCI World Index by a significant margin (32.07 percentage points), and marginally out-performed the MSCI Emerging Markets Index (1.88 percentage points)

Figure 1: Relative Performance vs. World Markets



Source: GIC Equity Research, Morgan Stanley Capital International

## Contribution Analysis

A break-up contribution analysis indicates that the Saudi market accounted for a substantial portion of the gains, contributing 18.5 percentage units towards the total returns, followed by the Emirates with 10.2, and Kuwait with 7.5. Qatar, Oman and Bahrain chipped-in with contributions of comparatively lesser significance.

On a sectoral comparison, the Banking sector was the major driving force, with 14.1 percentage units of the gains accruing from the sector, followed by the Telecom sector with 4.6.

Table XV: Return Contribution Analysis

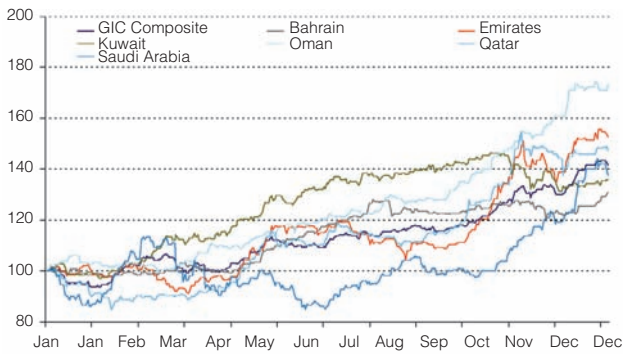
GIC Composite Index Closing Value	7,339.52
Value Traded (\$ mn)	696,305
Value Traded Previous Year (\$ mn)	1,091,182
Change During Year	41.6%
Change During Previous Year	-43.1%
Market Cap (\$ mn)	290,802
<b>Country Contribution</b>	
Bahrain	0.8%
Emirates	10.2%
Kuwait	7.5%
Oman	1.4%
Qatar	3.2%
Saudi Arabia	18.5%
<b>Sector Contribution</b>	
Banking	14.1%
Telecom	4.6%
Other	23.0%

Source: GIC Equity Research and Morgan Stanley Capital International

### Country Performances

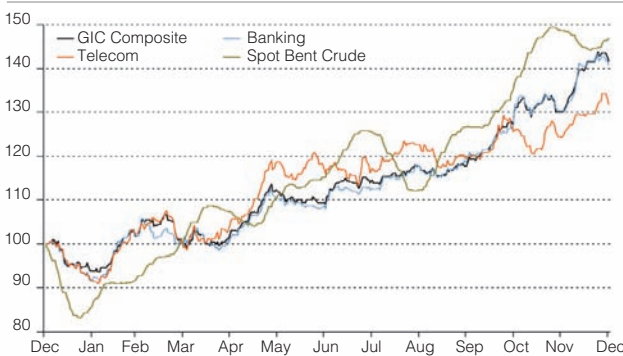
Amongst the country indices, Oman emerged the leader by a significant margin, as the GIC Oman Index closed at 5,111.02, with gains of 73.13%. The GIC Emirates Index closed at 8,247.31, clocking gains of 56.32%, closely followed by the GIC Qatar Index which closed at 10,239.95 with gains of 47.37%. The Saudi, Kuwait and Bahrain country indices under-performed the GIC Composite. The GIC Saudi Index closed at 5,549.58 after having gained 37.6% for the year, followed by the GIC Kuwait Index at 9,315.42 with gains of 35.76%. The GIC Bahrain Index rounded up the rear as it gained 30.77% to close at 3,285.20.

Figure 2: Performance of Individual Country Indices (Normalized)



Source: GIC Equity Research

Figure 3: Performance of GIC Composite Sector Indices Relative to Crude Oil

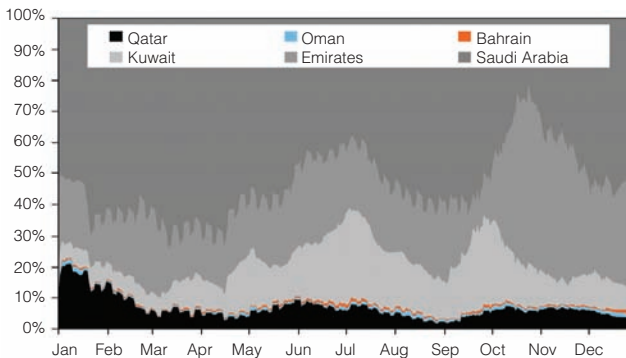


Source: GIC Equity Research

### Trading Activity

Trading Activity was still dominated by Saudi Arabia representing an average of 53.85% of the total traded liquidity during the year, thus reiterating its position as the most liquid market in the region. Emirates and Kuwait retained their positions as the second and third most liquid markets despite falling below last year's levels, with 24.47% and 13.62% respectively. Qatar accounted for the fourth largest chunk of trading volumes, with its share rising to 6.37% from 2.32% in 2006. Oman and Bahrain were the laggards, with their respective shares of 0.82% and 0.52% respectively.

Figure 4: Contributions to Value Traded



Source: GIC Equity Research

## Volatility

During 2007, volatility appears to have abated from its 5-year average, as evident from the figures. The GIC Composite Index witnessed a markedly lower deviation of 11.4%, vis-à-vis the 5-year average of 18.2%. Notable differences are seen in Kuwait, Oman and Qatar, while the Emirates and Bahrain recorded marginally lower levels. Saudi was the sole market to have recorded higher, albeit marginal, deviation in 2007, as compared to the historic average.

Table XVI: Risk Return Analysis

	Return	Volatility
<b>2007 (Actual Data)</b>		
Composite	41.6%	11.4%
Bahrain	30.8%	11.7%
Emirates	52.7%	19.7%
Kuwait	35.8%	13.6%
Oman	73.1%	10.7%
Qatar	47.4%	18.3%
Saudi Arabia	37.6%	26.8%
Banking	40.8%	12.7%
Telecom	31.9%	14.3%
MSCI World	9.6%	12.9%
MSCI EMF	39.8%	20.5%
<b>2002-2006 (Average Annual Data)</b>		
Composite	31.0%	18.2%
Bahrain	25.6%	11.4%
Emirates	35.8%	23.0%
Kuwait	32.8%	16.6%
Oman	39.2%	13.9%
Qatar	34.6%	23.4%
Saudi Arabia	25.5%	30.8%
Banking	30.8%	18.1%
Telecom	27.4%	20.2%
MSCI World	8.0%	13.3%
MSCI EMF	25.0%	15.4%

Note: Volatility represents the Annualized Standard Deviation of Daily Returns (12M Data)

Source: GIC Equity Research



## Country Review

The **Saudi** market remained volatile during the course of the year, with moderate rallies curtailed by corrective phases. However, the last quarter was very eventful, and the market witnessed a sharp rally that continued largely unabated till the end of the year. The partial unshackling of investor restrictions, with the Banking and Insurance sectors being opened to GCC investors, proved to be a shot-in-the-arm, as investors reacted positively, and with guarded optimism that the liberalization would continue to the extent of allowing foreign investors into these sectors.

The **Kuwaiti** market had a sustained bull-run from the beginning of the second-quarter that lasted well into the fourth quarter, before succumbing to some turbulence that helped in moderating the market. The decision of the Kuwaiti parliament towards the end of the year, to reduce taxes on foreign companies and remove capital gains taxes on foreign investors, came as a welcome relief for investors, and is likely to be a significant catalyst towards boosting foreign capital inflows during 2008.

In the **UAE**, the Banking and Finance sectors were in the limelight, prodded by a landmark merger and promise of more to come, while the underlying earnings growth continued to expand. As a country, the UAE attracted global attention with its grandiose real-estate projects, and transparent investment initiatives. Foreign capital flowed into banking and real-estate companies, some of which posted returns well into the 3-figure mark, and volumes received a fillip.

The **Qatari** market witnessed many ups-and-downs during the course of 2007, as mild rallies were subject to corrective actions at short intervals. However, a sustained rally during the fourth quarter pushed the index up to a 2-year high, before being broken by a sharp correction at the end of the year. Though the market witnessed largely broad-based movements during the year, the Industry sector emerged the best-performing, followed by the Services and Banking sectors.

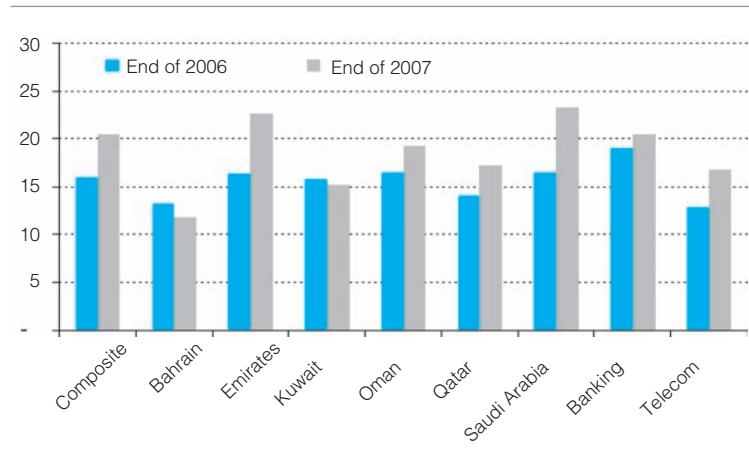
The **Omani** market witnessed a rather uncharacteristic rally towards the end of the year that pushed the market to a record high. The rally was broad-based with all sectors recording improvements, though the gains were more pronounced in the Banking sector. Hand-picked Industrial and Service stocks were also targeted, as liquidity was boosted by a sharp rise in foreign-capital inflows.

In **Bahrain**, the index recorded a strong second-half, building up on sharp gains in the third-quarter. Banks were in the limelight, driven by acquisitions and cross-border integration, with an aborted-acquisition thrown in for good measure. Industry and Service companies, save for a few exceptions, were largely relegated to the sidelines.

## Valuations and Yield

In line with the rise in prices, aggregate valuations across the markets witnessed a rise, with the exception of marginal dips in Bahrain and Kuwait. As corporate earnings growth strengthened, the threshold of acceptable valuations appears to have risen, as investors remained positive of earnings growth in the future.

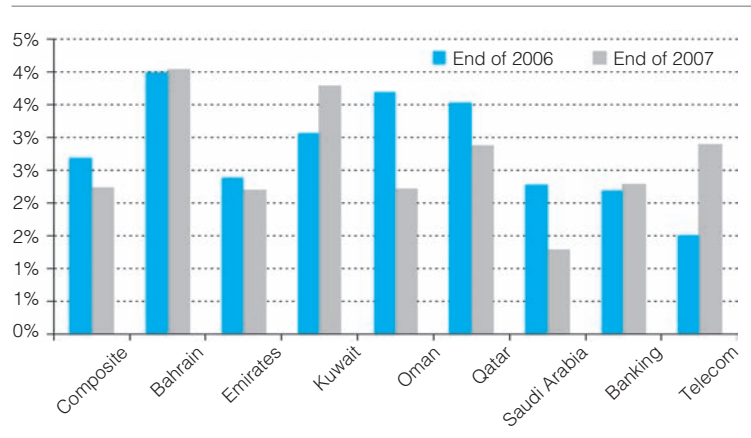
Figure 5: Trailing PE



Source: GIC Equity Research, regional exchanges.

Dividend Yields witnessed a change, which was rather mixed amongst the markets. While yields contracted in Saudi, Oman and Qatar following the sharp rise in prices, it remained relatively unchanged in Bahrain and the Emirates, and showed an improvement in Kuwait, as the payout improved

Figure 6: Dividend Yield

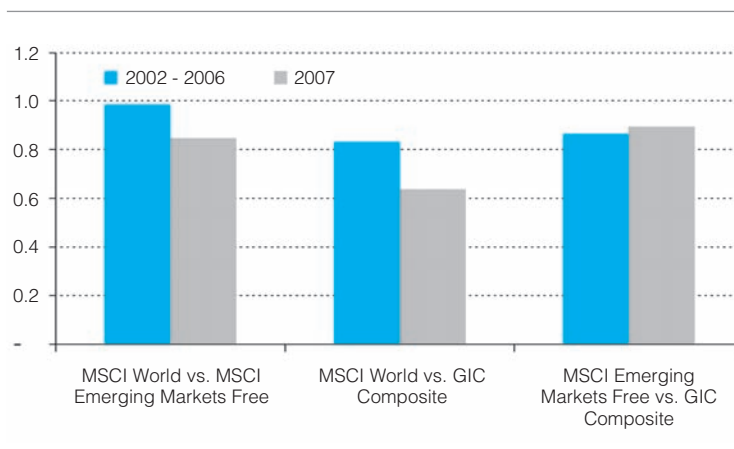


Source: GIC Equity Research, regional exchanges.

**Correlation with World Markets**

The prevailing trend during the past years in relation to the MSCI World, MSCI Emerging markets, and the GCC Composite was a clear cut correlation in terms of direction but not magnitude. GCC region has historically outperformed both indices by a significant margin, though all indices exhibited positive performances. During 2007, the disconnect between the MSCI World and GIC Composite indices deepened, while the correlation between the MSCI Emerging Markets Index and GIC Composite remained on an even keel with the historic average.

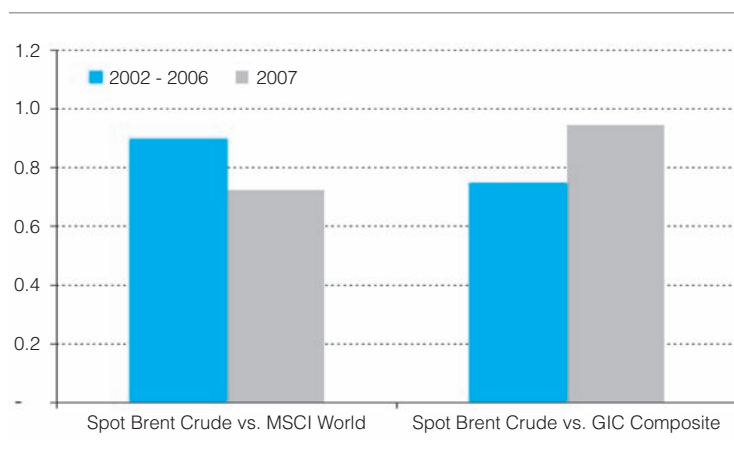
Figure 7: Correlations among Stock Indices



Source: GIC Equity Research, Morgan Stanley Capital International

During 2007, the correlation between the GIC Composite Index and Brent Crude has strengthened from the historic average, and is in sharp contrast to 2006, when the correlation between the GIC Composite and Brent had been negative

Figure 8: Changes in Correlations with Crude Oil

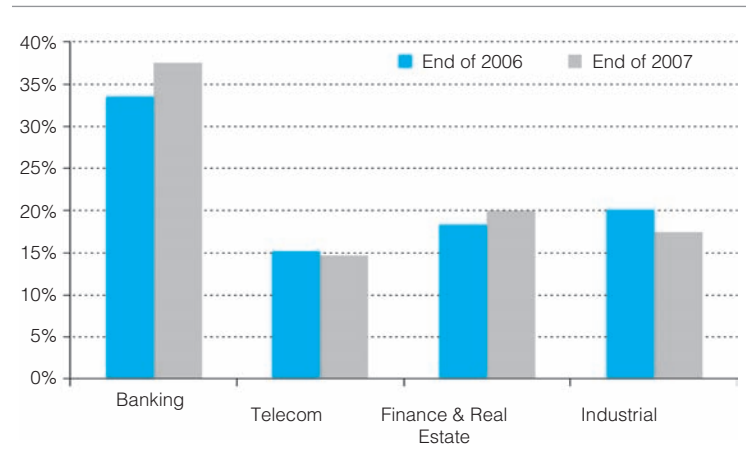


Source: GIC Equity Research, Morgan Stanley Capital International Reuters

### Composite Weightings

Reflecting the sectoral performance of the regional markets, the sector weightings have shifted marginally. The dominance of the Banking sector has risen, with its representation in the GIC Composite rising from 33.4% in 2006 to 37.5% in 2007. The Finance & Real estate sector has also moved ahead and accounts for 20% of the GIC Composite at the end of 2007. While the Telecom sector remained relatively unchanged at 14.6%. The representation of the Industrial sector continued to decline during 2007, as it did during 2006, and counts for 17.3% of the Composite Index.

Figure 9: Changes in GIC Composite Sector Weights

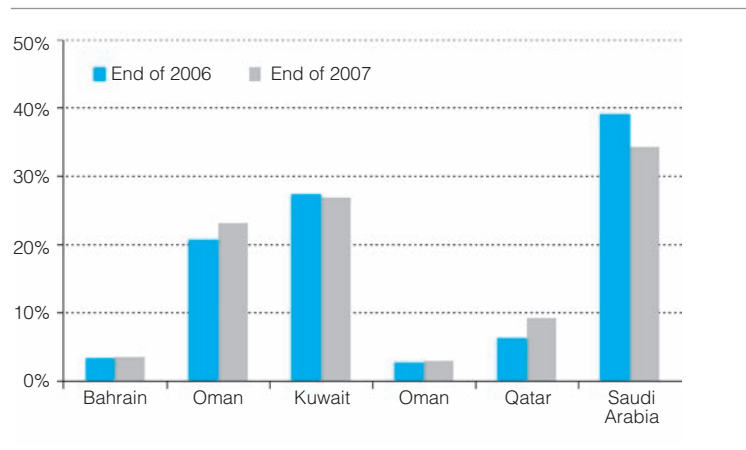


Source: GIC Equity Research

### Shifting in Country Weights

With the Emirates increasing its representation in the GIC Composite Index to 23.2% from 20.8% at the end of 2006, the weighting of Saudi Arabia has fallen to 34.2%, from 39.1% in 2006, and from the high of 57.4% in 2005. Qatar has also improved its presence in the Index, with its representation rising from 6.5% to 9.2%. Meanwhile Kuwait, Oman and Bahrain remained relatively unchanged. In terms of weighting, Saudi still retains its leading position, accounting for 34.2%, followed by Kuwait with 26.9%, Emirates with 23.2%, Qatar with 9.2%, Oman with 3.1% and Bahrain with 3.5%

Figure 10: Changes in GIC Composite Country Weights



Source: GIC Equity Research

In concluding the economic review section we emphasize that the year was asymmetric in outlook, particularly in the second half. The international environment became more cloudy and uncertain, with markets facing a crisis of liquidity and investor confidence. The regional environment, however, exhibited a different picture of business confidence and optimism. But, we live in a globalized world and if the international economies and markets face a recession in the coming year, our region will undoubtedly be affected, especially if such a recession is severe.

# Financial Review





### **Our Financial Goal:**

To maximize long-term shareholder value through consistently superior financial performance while maintaining strong financial condition.

### **Our Financial Performance Objective:**

To consistently achieve target earnings growth and return on equity, with an appropriate dividend payout.

### **Our Financial Condition Objective:**

To efficiently manage the various forms of risks associated with our business and maintain strong asset quality, capital base and liquidity, while achieving target balance sheet growth.

### Net Income Analysis

Gulf Investment Corporation (GIC) posted net profit of US\$ 253 million for the year 2007, which represents return on equity of 14.9%. Globally the year 2007 was very challenging for international capital markets in general and liquidity markets in particular. GIC managed to post growth of 22.3% on year-on-year net operating income before impairments and exceptional items. This reflects sound strategic planning in diversification of assets and revenue resources and managing the risks.

Net profit for the year was impacted by impairment charges of US\$ 246 million mainly on structured credits and SIVs. It is worth mentioning that the SIVs did not suffer from the quality of its underlying assets but the main problem was the lack of liquidity internationally affecting the cost of financing the structure. GIC's exposure to subprime and monoline insurers is very limited and GIC has made full provision for it.

GIC achieved excellent results in most of the other investment activities. Private equity funds, GCC equities and money markets posted outstanding results whereas non-conventional asset portfolios improved upon their prior year's superb performance. Commission and fees income increased significantly during the year. Timely realization of profits in Global Equities and Global Reits portfolios endorses success of GIC's strategies in ever changing economic scenario.

GIC achieved superior level of operational profitability on the strength of its core investments, diversified blend of investment activities and dynamics of asset mix in an ever-challenging investment environment.

Analysis of the contributing components confirms the accomplishment of GIC's major objectives and strength of investment philosophy.

#### Interest and Similar Income

Interest income is generated from debt securities portfolio, structured products, proceed from money market book, SIVs and loans.

Gross interest and similar income grew by 21.3% to US\$ 308 million during 2007.

Investment in interest bearing securities and funds is primarily made to generate spread income. Though the interest rates started softening in later part of the year, higher average interest rates in most of the current year made it a testing task to enhance this income. Further, spread based investment structures witnessed the most difficult time of their existence. GIC's proactive approach in timely hedging a major portion of long duration fixed rate debt securities, limiting the risky exposures and maintaining the quality of investments helped GIC in facing the challenging time.

GIC's money market activity continued to generate strong interest earnings in 2007, which shows commendable growth of 40% on the prior year.

Income from loan book at US\$ 1.9 million increased by 19.5% over the prior year due to strategic lending to a project as a part of equity bridge finance.

Due to subprime turmoil, margin from spread based structured investments remained under pressure.

#### Investment and Fee Income

Investment and fee income for the year amounted to US\$ 472 million. Year 2006 income of US\$ 576 million included one time gain on exchange of investment available for sale amounting to US\$ 170 million. Excluding the above, investment and fee income for the current year posted an increase of 16% over the year 2006 comparative income. Results of GIC's long-term strategy to contribute to the growth of GCC region at a commercial rate of return continued corroborating with fine performance of investments in GCC projects. Judicious allocation of other investments made for risk diversification added to the performance for the year.

A detailed breakdown of Investment and Fee income is available in Note 19 to the financial statements. The key constituents are discussed below.

Net gain on interest bearing securities and funds declined to US\$ 3 million compared to US\$ 23 million in the prior year, mainly due to realized loss of – US\$ 21 million on liquidation of two investments in SIV portfolio. Other constituents of this income include realized gains from available for sale securities, which at US\$ 14 million show a growth of 75% over the prior year largely due to gains on liquidation of High Quality Sovereign Bond portfolio. It also includes gains from sale and market value changes of managed debt funds held for trading, which substitute the interest income. Income from managed debt funds declined to US\$ 10 million from US\$ 15 million in 2006 due to liquidation of money market enhanced liquidity funds amounting to US\$ 220 million.



Net gains on equities and managed funds at US\$ 183 million posted an increase of US\$ 74 million or 68% up on the prior year. GIC's equity exposure witnessed excellent performance in 2007. Barring few exceptions, nearly all the portfolios marched ahead of their prior year performance with the most remarkable performance posted by GCC Equities portfolio – Gulf Premier Fund, which turned around from loss of –US\$ 16 million in the prior year to a profit of US\$ 11 million in 2007. Alternative equity investments continued their last year's outstanding performance. Alternative equity investments mainly comprising of hedge funds posted record earnings for the year. Such investments cover a broad range of strategies including relative value, event driven, long-short, global macro, and are managed by a well diversified pool of external managers. Strategic moves in Global Equities and Global Reits portfolios produced a realized profit of US\$ 50 million for the year 2007, which was more than twice the prior year income of US\$ 24 million.

Net gains of US\$ 68 million were realized from the sale of investment in two projects and some partial liquidation. Pre-determined strategic exit points, restructuring of the portfolio coupled with market opportunities translated into vision realization. Besides the realized gains, quoted investments in projects and equity investments in associates appreciated by a total of US\$ 136 million forming part of revaluation reserve in shareholders' equity.

Net gains from liquidation of few investments in private equity funds at US\$ 86 million in 2007 more than tripled compared to US\$ 28 million earned in the previous year. In addition, dividends of US\$ 1 million received during the year are included under "Dividend Income".

Management believes that the gradual recovery witnessed by the global private equity sector is likely to continue in the future.

Projects and equity participations posted earnings of US\$ 36 million, lower by 35% compared to prior year. This represents mainly GIC's share of profits from unconsolidated subsidiaries and associated companies. Further, GIC's investment in a project made last year with the intention to resell fetched share in the profit US\$ 7 million and liquidation profit of US\$ 21 million on the sale of remaining portion. Additionally, dividend income of US\$ 11 million was earned and is included

within the "Dividend Income" category. Lower performance in the current year was partially due to the impact of new acquisitions in one of the key projects and losses incurred by green field ventures in start-up mode. Restructuring process in few projects partially affected the overall performance for the year. Financial results of new ventures indicate the activity as planned towards the completion of conceived projects, which are expected to make significant contribution in the coming years. Further, GIC's exposure in mega projects in power, utilities and other sectors is expected to sustain the future growth.

With representation on the Board of Directors of most of the projects, the principal investing team plays an active role in the strategic management of these companies and continuously monitors performance. GIC adheres to a policy of strict financial discipline while evaluating and managing project investments, seeking ventures that will provide a market rate of return.

Dividend income of US\$ 22 million comprising of receipts from private equity funds, project investments, managed portfolios and funds increased by 22% over the previous year. Dividends from projects and GCC Strategic Equity portfolio were up by more than 75% and 35% respectively compared to prior year. Overall increase in dividends was partially offset by lower dividends from private equity funds.

Fees and commissions income of US\$ 41 million for the year was up by 46% compared to prior year. This was primarily due to receipt of project development fees of US\$ 18 million for two utility projects. Fee income was generated by management of funds, financial advisory, development of projects and providing custodial and administrative services to the funds managed by third parties. The Business Development team aims to deliver a range of financial products available in the international markets, in addition to the sale of internally developed GCC investment products to clients in and outside the region. Emphasis will continue to be on expansion of fee – based revenues to help diversify revenue sources into lower risk assets with lower capital utilization.

### Income from Recovery of Debt

GIC's efforts for recovery of written off loans to entities within Republic of Iraq paid off with the receipt of US\$ 103 million in final settlement booked during the current year.

### Operating Expenses

Operating expenses at US\$ 52 million were lower by US\$ 4 million or 7% compared to prior year. Year-on-year increase was recorded mainly in staff expenses, which was more than offset by decline in premises and other operating expenses. Part of the saving was due to reversal of prior year accruals.

Staff cost constituting 75% of the total operating expenses increased by US\$ 5 million compared to prior year. This was primarily due to retain and attract the best in the industry to meet the growth requirements.

Productivity, expressed in terms of total operating income as a multiple of related operating expenses was 8.6 compared to 9.8 in 2006.

Premises expenses of US\$ 1 million declined by US\$ 3 million as the prior year expenses included cost of relocation of back office functions and also due to reversal of accrual provisions of prior years no longer required.

Other operating expenses declined by more than 33% mainly due to reversal of prior year accruals. Excluding the prior year reversals, current year other operating expenses were higher by 14% primarily due to higher fees expenses.

### Provisions/Impairment Losses

We provide for impairment losses and maintain provisions to absorb losses inherent in our business that we believe are probable and that can be reasonably estimated. Given the varied nature of businesses, these may arise from our lending, treasury and investment activities. Estimating losses is inherently uncertain and depends on many factors, including general, macroeconomic and political conditions, rating migration, risk concentration, structural changes within industries, and other external factors such as legal and regulatory requirements. The corporation periodically reviews such factors and reassesses the adequacy of the impairments.

Net charge for the year in provisions/impairment losses was US\$ 246 million, higher by US\$ 241 million charged in 2006, which was primarily due to impairment in the value of structured credits and SIVs. Impairment losses were provided on SIVs (US\$ 139 million), structured credits (US\$ 101 million), equities and managed funds –available for sale (US\$ 5 million) and additional provisions were made on loans and loan guarantees (US\$ 3 million) and contingent liabilities (US\$ 1 million). Provisions no longer required on placements with non-bank financial institutions (US\$ 1 million) and accounts receivable (US\$ 2 million) were reversed. Accumulated provisions of US\$ 38 million on private equity funds were transferred to shareholders' equity as the investment is now fully carried at fair value. Central Bank of Kuwait vide their circular reduced the rate of general provision on placements with non-bank financial institutions and loans from 2% to 1% and on loan guarantees from 2% to 0.5%. Accordingly general provision on the said categories is made at new rates and the existing provision of US\$ 3 million is kept in a separate account till further instructions from CBK. A detailed break down is provided in Note 22 to the Financial Statements.

### Balance Sheet Analysis

In line with our aim of optimizing capital utilization through the growth of total assets and an emphasis on risk adjusted return criterion in asset allocation decisions, total assets during the year reached US\$ 9,148 million, up 13% over the previous year end. 2007 witnessed a substantially more balanced expansion in assets within private equity and interest bearing securities. The private equity funds recorded growth of 35% while interest bearing securities were up by 9%.

Diversification in sources of revenue was further enhanced during 2007 with investments being made in products with finer risk- return characteristics.

The corporation's strategic focus continues to be on the GCC states and their major trading partners in the industrialized world. Note 25.3.1 to the Financial Statements sets out the geographic distribution of the Corporation's credit risk exposure.

The following sections provide details on the key asset categories.

### Interest Bearing Securities and Funds

As at 31 December 2007, interest bearing securities and funds made up 57% of GIC's total balance sheet assets. The portfolio witnessed a net increase of 9% during the year. This was largely contributed by the establishment of a new FRN portfolio comprising of mainly AAA rated securities. Balance of Iraq Government Bonds received in 2006 in settlement of amounts due from entities within the Republic of Iraq was fully liquidated at a profit during the year. The investment within the portfolio is composed mostly of investment grade marketable debt securities. Investments in trading funds, at US\$ 197 million, which are interest rate related form less than 4% of this portfolio.

Interest bearing securities totaled US\$ 4,990 million at 31 December 2007 as against US\$ 4,349 million at end of 2006. The interest bearing securities portfolio includes securities available for sale of US\$ 4,443 million and securities held to maturity of US\$ 547 million. Approximately 96% of the debt portion of the investment portfolio is made up of plain floating rate notes or fixed rate securities swapped into floating rate using interest rate swaps. The balance comprises fixed rate securities of a shorter duration.

Approximately 94% of the portfolio comprised of rated and GCC Government securities. A credit risk analysis of the investment securities portfolio is provided in the risk management section of this report, and other details, including rating profile, are contained in Note 5 to the Financial Statements.

Trading funds declined by 50% mainly due to liquidation of most of the money market enhanced liquidity funds. Total decline in money market funds was partially offset by increase in bond funds.

### Loans

This category includes loans and advances of US\$ 40 million. Outstanding loans increased by 135% year-on-year mainly on account of short-term equity bridge loan of US\$ 34 million to one of GIC's new projects. Existing commercial loans are allowed to run-off, which is in line with the strategic decision to discontinue this business except loans to projects.

Based on contractual maturities at the balance sheet date, all the current outstanding loans are due to mature by the end of 2008. Details of the liquidity profile are given in Note 25.1 to the Financial Statements and other details including loss provision made are contained in Note 7 to the Financial Statements. As of 31 December 2007, loans and advances were entirely to entities within the GCC region. There were also no significant concentrations by industrial sector at the year-end.

Total loan loss provisions including loan guarantees amounted to US\$ 5 million at 31 December 2007. Counterparty specific provisions amounted to US\$ 2 million while general provisions were US\$ 3 million. The specific provisions were made against loans, guarantees and related exposures to project investments. Specific provisions for loans are made to the full extent of the estimated potential loss while general provisions are maintained to cover possible future losses, which as yet have not been specifically identified. It is the Corporation's policy to write off loans after all reasonable restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote.

### Equities and Managed Funds

Equities and managed funds totaled US\$ 1,387 million at 31 December 2007 as against US\$ 1,154 million at end of 2006 indicating a net increase of 20% during 2007. Equities and managed funds include available for sale securities of US\$ 295 million and equities and managed funds classified as trading and 'fair value through income statement' of US\$ 431 million and US\$ 661 million respectively. A decline of almost 9% was witnessed in Equities and Managed Funds available for sale, which was largely, brought about by the net liquidation of positions within the Global Reits, Global Equities and Subordinated Notes portfolios though partially compensated by net increase in exposure to GCC Strategic Equity portfolio. The bulk of the remaining portfolio of equities and managed funds broadly classified as trading comprises of investments in a range of alternative asset strategies, managed by a diverse pool of external managers. The portfolio of alternative asset investments is continuously monitored and restructured to fit GIC's risk-return profile, while gradually expanded in line with growth targets. The Alternative Strategies Fund (ASF), managed by GIC in association with internationally reputed managers, had another successful year.

### Placements and Other Interest Bearing Assets

Placements amounted to US\$ 623 million at 2007 year end. Reciprocity is a key feature of our placement policy. Note 25.1 to the Financial Statements provide the liquidity profile of placements. All placements mature within one year. Of this, US\$ 502 million had a maturity within three months. Securities purchased under resale agreements amounted to US\$ 186 million at 31 December 2007 compared to US\$ 14 million at end of 2006. Other liquid assets at the balance sheet date included US\$ 9 million cash and bank balances.

### Private Equity Funds

Private Equity funds amounted to US\$ 305 million at 31 December 2007, up 35% compared to the prior year. The portfolio is principally invested in equity investments of a structured finance nature with a wide range of externally managed private equity funds. These funds invest in leveraged and un-leveraged acquisitions, privatizations, recapitalisation, rapidly growing companies, expansion financings, turnaround situations and other special equity situations.

Investments in private equity funds are carried at fair value. In prior years an impairment provision of US\$ 38 million was made on a conservative basis. Based on the information obtained, primarily from independent managers, it is believed that there is no impairment and accordingly the existing provision was reversed to equity. Details on private equity funds are provided in Note 8 and Note 17 to the Financial Statements.

### Investment in Project Held for Sale

As enumerated in Note 9 to the Financial Statements, in 2006, the Corporation acquired the remaining 50 percent of the shares outstanding of Gulf Industrial Investment Company (E.C.) for a consideration of US\$ 377.0 million. Subsequently half of the investment was sold in the same year and remaining half was sold during the current year at a profit of US\$ 21 million.

### Investment in Projects and Equity Participations

Investments in projects and equity participations amounted to US\$ 1,078 million at the end of 2007, compared to US\$ 879 million at the end of 2006, which is 23% over previous year. This category includes a mix of investments in unconsolidated GCC and other subsidiaries and equity stakes mainly in GCC companies.

During 2007, the principal investing team was active on all fronts. This included restructuring of existing investments which entailed the complete exit from two projects, partial sale of holding in a quoted project, additional investment in three existing projects and new investments in four new projects. The principal investing team also conducted exhaustive appraisals of several other projects, some of which have been approved or are in the final stages of approval. New additions included investments in diversified projects comprising of utilities, manufacturing and health services.

Net provisions of US\$ 60 million during the year remained at the same levels of 2006. Detailed analysis of the portfolio and related provisions, is contained in Note 10 to the Financial Statements. A list of the Corporation's direct investments is also given on page 117.


### Property and Other Assets

Including property and fixed assets, total other assets amounted to US\$ 333 million at 31 December 2007. Of this US\$ 18 million related to property and other fixed assets. The remaining US\$ 315 million comprised of accrued interest and fees receivable, derivative assets used for hedging, employees' end of service benefit asset, accounts receivable, prepaid expenses and other miscellaneous assets. Details are set out in Notes 11 and 12 to the Financial Statements.

A more detailed discussion on liquidity and funding, the various risks associated with our business activities, and capital strength is included in the Risk management section that follows.

# Risk Management





The financial goal of the corporation is to consistently earn competitive returns, while maintaining risks within acceptable levels. Recognizing the relationship between returns and risk, the management of risk forms an integral part of the corporation's strategic objective. The continuous and rapidly changing business environment has increased the complexity and diversity of risks. The goal of risk management is not to avoid risks, but to understand and manage them.

The various business activities of the corporation generate a wide spectrum of risks. The four primary risks assessed are credit, market, liquidity and operational. Management of these risks through investment in knowledge and systems has been a priority at GIC. A combination of competent and experienced staff, quantitatively based analytical tools, and ongoing investment in technology are the key resources used to manage our risks effectively. The qualitative and quantitative techniques utilized to optimize the risk return profile incorporate information from the past, trends in the present business environment, and expectations of the future.

Risk management begins with management defining its risk appetite. This is followed by a three step process: identifying and measuring the various risks generated, monitoring and controlling them, and finally optimizing in relation to return.

The primary function of the independent Risk Management Division is to develop and maintain a common risk management framework that serves as a basis for setting policies and limits and for enhancing GIC's ability to manage risks, evaluate performance and allocate capital. This unit acts as a critical link between management and the risk taking divisions – assisting management in defining / quantifying its risk appetite and then effectively communicating this to the risk takers and ensuring that the risk taking activity is within management's acceptable levels.

Within the corporation, responsibility for management of risks is not restricted to a single division. The philosophy adopted has been to encourage a culture of prudent risk management across all business and support areas.

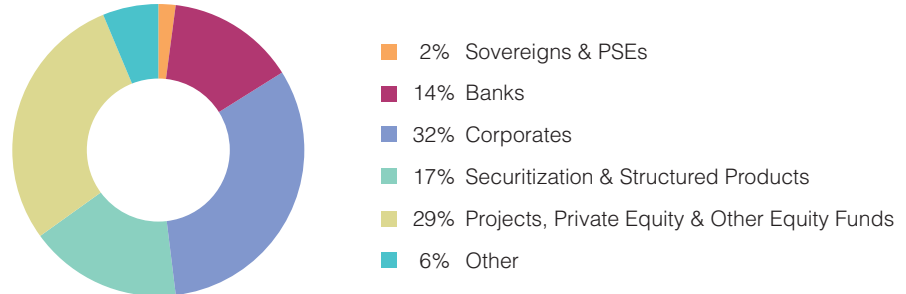
From the perspective of control, the process of risk management is facilitated through a set of independent functions in addition to the Risk Management Division. These units, which report directly to senior management, include Financial Control, Internal Audit and Compliance. This multi faceted approach aids the effective management of risks by identifying and monitoring risks from a variety of perspectives.

The process of managing the four risk categories identified above are discussed in more detail in the following sections.

**Credit Risk**

Credit risk is the possibility of loss arising from the failure of an obligor to completely fulfill its contractual obligations. In its various on and off-balance sheet business activities, the corporation seeks opportunities to take credit risk prudently and manage it effectively to achieve competitive returns. Credit risk is managed concurrently at the transaction, obligor and portfolio levels.

Sources of Credit Risk (Weighted Credit Risk Exposure)



An activity-wise break down of the principal sources of credit risk is illustrated in the pie chart above. The proportions reflect Credit Risk Weighted Exposure, computed based on Basel2 capital adequacy guidelines.

The primary tool used in the management of credit risk is a set of well defined credit policies and procedures. In addition to communicating management’s risk appetite in the form of limits for country, product, industry and obligor, these policies detail the process of measurement, monitoring and reporting. The stringent credit approval framework mandates a rigorous and thorough evaluation of creditworthiness of each obligor, after which limits are approved by management. Additionally, limits for product and industry are also defined to ensure broad diversification of credit risk. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.



The credit risk management process utilizes statistical methods as well, to estimate expected and unexpected loss amounts for the various business activities. The system, based on Creditmetrics methodology, enables accurate credit risk measurement on an individual exposure as well as a portfolio basis. Expected and unexpected loss estimates are computed based on probabilities of default (PD) and loss given default (LGD) data published by leading rating agencies.

The Debt Capital Markets portfolio, which forms the largest asset class and constitutes approximately 40% of the balance sheet is monitored against a credit VaR limit, approved by the board. The US\$ 200 million VaR limit (99.96% confidence, 1 year), which supplements the existing notional limits for this portfolio, is based on creditmetrics methodology and is measured using monte carlo simulation techniques.

The table below provides the Credit Value at Risk (Credit VaR) figures for the Debt Capital Markets Portfolios.

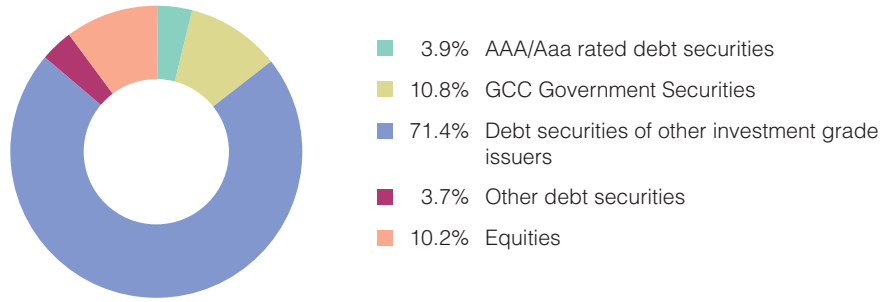
2007 Credit Value at Risk - 99.96% confidence level, 1 year holding period

US\$ 000's	Average	Minimum	Maximum	31 Dec 2007
Debt Portfolios	154,140	139,813	168,639	153,247

Although, business units are responsible for maintaining exposures within limits, actual exposures are continuously monitored by independent control functions including Risk Management, Financial Control, Compliance and Internal Audit. Technology is a key element in the monitoring process and in this regard, cutting edge systems, capable of close to real time monitoring and control of risk taking activities, are being effectively utilized.

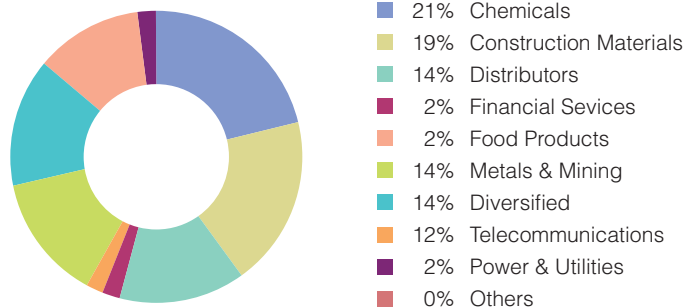
As of end 2007, the key components of the corporation's total credit risk exposure were investment debt securities of corporates and banks, securitization and structured products and projects, private equity and other equity funds. Approximately 80%, or US\$ 4billion, of the US\$ 5.1 billion investment securities portfolio is made up of high grade debt securities, of which 92% are of issuers rated investment grade or better. GCC Government Securities and Structured Notes constitute the remainder of the investment securities portfolio. The superior quality of the portfolio is highlighted in the rating profile on page 39. Independent compliance and control units continuously monitor the portfolio for adherence to stringent portfolio guidelines.

Rating Profile - Investment Securities Portfolio



The projects, activity focuses on the GCC countries, a region whose dynamics we comprehend well and where we have a better understanding of the inherent risks. Investments are made after rigorous qualitative and quantitative analysis, and where the desired risk-return objectives are met. As is highlighted in the chart below, a healthy diversification across industry sectors is maintained within this portfolio. Private Equity and other Equity Funds represent investments made with third party fund managers typically in the United States and Europe who are chosen after consideration of their records and extensive due diligence. Securitization and structured products portfolios, managed by a range of experienced and highly rated fund managers, are invested in structured finance transactions. During the year the market value of the corporations investments in these products was affected by adverse market movements resulting in the corporation taking a provision of US\$ 139 million on these investments. Asset quality and market conditions of these structures are being continuously and carefully monitored. The corporation's lending activity is being gradually phased out, with the residual balance in the loan book amounting to just US\$ 40 million as of 31st December 2007.

Principal Investing (Projects) by Industry



### **Off-balance sheet Financial Instruments**

In the normal course of its business, the corporation utilizes derivative and foreign exchange instruments to meet the financial needs of its customers, to generate trading revenues and to manage its exposure to market risk.

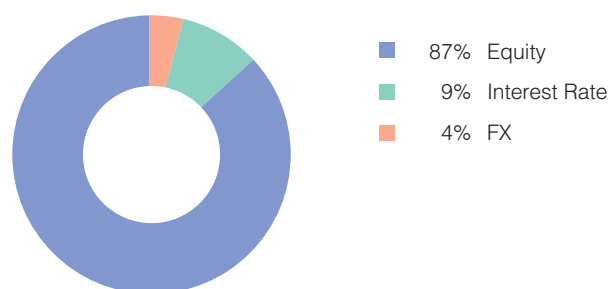
For derivative and foreign exchange transactions, procedures similar to on balance sheet products are used for measuring and monitoring credit risk. Credit risk weighted exposure to off balance sheet products amounted to about 8% of total credit risk weighted exposure. This amount represents the mark-to-market or replacement cost of these transactions. At the year end 2007, there were only trading foreign exchange contracts outstanding, 99% of which were short term with a maturity of less than one year. Credit risk amounts arising from these transactions relate to major banks. Off balance sheet transactions also include credit-related contingent items designed to meet the financial requirement of the corporation's customers. A detailed credit risk analysis of credit-related contingent items, derivatives and foreign exchange products is set in Notes 25 & 26 to the financial statements.

Although, detailed and thorough analysis is conducted prior to taking on credit risk, unforeseen events could trigger a decline in the credit-worthiness associated with a transaction, resulting in loss. Adequate levels of provisions are set aside to cover such losses. The corporation's provisioning philosophy, including numerical analysis, is discussed in the financial review section.

### **Market Risk**

Market risk is the possibility of loss in value of financial instruments, resulting from an adverse change in market factors. Within the corporation, market risk is made up of three key risk constituents – interest rate risk, equity risk and foreign exchange risk. A breakdown, based on risk constituents, is provided below for the combined mark-to-market and investment activities, within the Global Markets Group alone (strategic equity positions within the Principal Investment business is not included). The percentages reflect average VaR amounts, considered independently, and ignore the effects of diversification across risk classes.

## Market Risk Constituents - Overall



Market risk is measured, monitored and managed, both on a notional basis, and using a Market Value at Risk (Market VaR) concept. Quantitative statistical methods combined with judgment and experience are used to effectively manage market risk. A system of limits and guidelines restrain the risk taking activity with regard to individual transactions, net positions, volumes, maturities, concentrations, maximum allowable losses, and ensure that risks are within the acceptable levels in terms of notional amounts. The VaR based system provides a more dynamic measure of market risk, capturing in a timely manner, the impact of changes in the business environment on the value of the portfolio of financial instruments.

Market VaR is calculated and reported to senior management on a daily basis at various levels of consolidation including portfolio, business unit and Corporation. The average, minimum and maximum value at risk amounts for the combined mark-to-market and investment activities (excluding strategic equity investments within principal investing) are tabulated below. These VaR measures are based on a 95% confidence level, 25 day holding period, and using exponentially weighted historical market data.

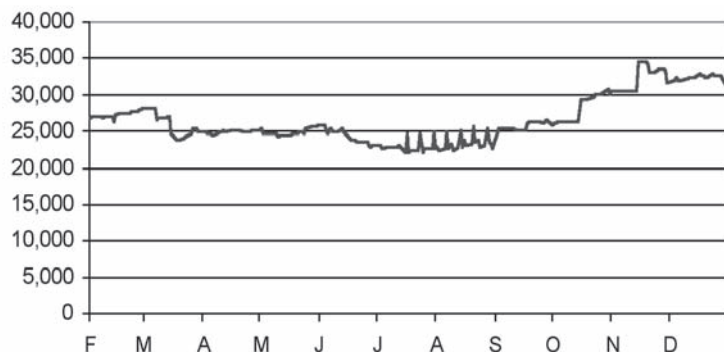
## Market Value at Risk for Global Markets Group alone - 25 day holding period, 95% confidence level

2007				
US\$ 000's	Average	Minimum	Maximum	31 Dec 2007
Interest rate	2,692	1,592	5,014	4,688
Equity	26,315	21,961	34,545	30,886
Foreign Exchange	1,221	466	2,784	1,722
<b>Total*</b>	<b>26,413</b>	<b>21,926</b>	<b>34,375</b>	<b>31,231</b>
2006				
US\$ 000's	Average	Minimum	Maximum	31 Dec 2006
Interest rate	2,766	558	4,323	2,938
Equity	29,978	26,124	33,987	27,405
Foreign Exchange	777	282	1,952	466
<b>Total*</b>	<b>30,664</b>	<b>26,607</b>	<b>34,646</b>	<b>28,080</b>

\* Total VaR incorporates benefits of diversification

During 2007, the average total VaR relating to market risk was approximately 14% lower than the average for the previous year, primarily as a result of lower equity related VaR. Total monthly VaR, remained within the approved limit of US\$35 million during the year. During the third quarter, as a result of increased valuations and modestly higher volatilities within the portfolio of alternative investment strategies, total VaR increased slightly. Interest rate VaR remained at modest levels, with the continued strategy of minimizing interest rate risk through effective hedging. The value at risk associated with exposures to alternative investment strategies is also quantified and aggregated with risk components of GIC's more conventional on and off balance sheet asset classes. A profile of daily VaR is provided below. At year end 2007, the Total VaR was US\$ 31.2 million.

Profile of daily VaR – 25 day holding period, 95% confidence level



Certain portfolios and positions are not included in the market VaR, since VaR is not the most appropriate measure of risk for them. These include the principal project investments in the GCC and the portfolio of international private equity funds. The market risk relating to these investments are measured in terms of a 10% sensitivity measure – estimated decline in asset values. The fair values of the underlying positions may be sensitive to changes in a number of factors, including, but not limited to, the financial performance of the companies, projected timing and amount of future cash flows, discount rates, trends within sectors and underlying business models. The table below provides the sensitivity measure for 2007 and 2006. The principal investment and private equity portfolios are both categorized as available-for-sale, hence, the 10% sensitivity measure provided in the table below reflects the impact on shareholders' equity, and not on profits.

Sensitivity Measure: for assets not included in market VaR (US\$ 000s)

Asset Categories	10% sensitivity measure	10% sensitivity measure (impact on shareholders' equity)	
		31 Dec 2007	31 Dec 2006
Principal Investments	Underlying asset value	107,779	107,690
Private Equity Funds	Underlying asset value	30,507	22,650

Scenario analysis is an essential component of the market risk management framework. The assumption of normality on which the statistical models are based may become invalid due to the occurrence of certain events. Future scenarios, which result in a breakdown of the historical behavior and relationships between risk constituents, are projected, and potential loss amounts are determined. Most of these scenarios are derived from macroeconomic events of the past, modified with the expectations for the future.

#### Liquidity Risk

Liquidity risk is the failure to meet all present and future financial obligations in a timely manner and without undue effort, whether it is a decrease in liabilities or increase in assets. This risk may be further compounded by the inability of the Corporation to raise funds at an acceptable cost to meet its obligations in due time.

There are two sources of liquidity risk that GIC takes into account, which are:

- Cash flow illiquidity**, arising from the inability to honor financial commitments or to procure funds at reasonable rates and required maturities; and
- Asset illiquidity**, relating to the lack of market depth during times when assets are to be liquidated on a forced basis.

The Corporation likewise believes that capital plays a special role in liquidity planning inasmuch as liquidity problems could arise in the short run if the market believes that capital has been so impaired that in the long run the Corporation may not be able to pay-off its liabilities.

GIC's management of liquidity considers an overall balance sheet approach that brings together all sources and uses of liquidity. More specifically, liquidity requirements cover various needs that are addressed by the Corporation's senior management. Among these needs are:

- meeting day-to-day cash outflows;
- providing for seasonal fluctuation of sources of funds;
- providing for cyclical fluctuations in economic conditions that may impact availability of funds;
- minimizing the adverse impact of potential future changes in market conditions affecting GIC's ability to fund itself; and
- surviving the consequences of loss of confidence that might induce fund providers to withdraw funding to GIC.

#### Liquidity Limits

As part of the funding and liquidity plan, liquidity limits, liquidity ratios, market triggers, and assumptions for periodic stress tests are established and approved. The size of the limit depends on the size of the balance sheet, depth of the market, the stability of the liabilities, and liquidity of the assets. Generally, limits are established such that in stressed scenarios, GIC could be self-funded.

The liquidity limits being monitored frequently include the following:

- Maximum daily cash outflow limit for major currencies;
- Maximum cumulative cash outflow which should include likely outflows as a result of draw-down of commitments, etc; and
- Net liquid asset ratio – this ratio is calculated by taking a conservative view of marketability of liquid assets, with a discount to cover price volatility and any drop in price in the event of a forced sale. The ratio is the proportion of such liquid assets to volatile liabilities.

The net liquid asset ratio as at 31st December 2007 was 132%. The following criteria were considered in determining this particular ratio:

- a) A 3-month remaining maturity is being used to establish the time threshold by which balance sheet items are determined to be liquid or illiquid, stable or volatile;
- b) Appropriate "haircuts" are applied on liquid assets to reflect the potential market discounts; and
- c) A "business as usual" posture is maintained in ascertaining the level of assets to be liquidated or pledged to avoid sending a wrong signal to the market.

The Corporation's investment portfolio is managed so that holdings of un-pledged, marketable securities that comprised the strategic reserve are equivalent to approximately 50% of the projected maximum cumulative cash outflow. As at end of December 2007, investments in marketable securities tallied at approximately US\$ 5 billion, and are primarily made up of investment grade securities.

The quantities of pledged securities are reviewed periodically so as to ensure that the quantity of pledged securities does not exceed the amounts actually required to secure funding or for other purposes. Additionally, to the greatest extent possible, the selection of securities to be pledged are made in a manner whereby the longest term and/or least marketable securities are utilized.

### Market Access for Liquidity

Effective liquidity management includes assessing market access and determining various funding options. Having said this, GIC deems it critical to maintain market confidence to attain the flexibility necessary to capitalize on opportunities for business expansion, and to protect the Corporation's capital base.

Proactive and prudent liquidity management requires a stable and diversified funding structure. To this end, GIC always maintains a well-balanced portfolio of liabilities in order to generate a stable flow of financing and to provide protection against sudden market disruptions. To the extent practical and consistent with other GIC objectives, the Corporation emphasizes both minimal reliance on short-term borrowed funds and also the use of intermediate and long-term borrowings in place of short-term funding.

A diversity of funding sources, currencies, and maturities are used to gain a broad access to the investor base. The Corporation's deposit base at year-end 2007 stood at about US\$ 2,804 million, of which approximately 83% are due to GCC deposits which, over the years, had proven to be stable source of funds. Additional short term funding is acquired through the use of repurchase agreements secured by a portfolio of high-grade securities. Such form of funding accounted for close to 26% of total funding at year-end 2007.

Financing through the issuance of medium term notes has been an effective source of funds for GIC. Over the years, the corporation's EMTN program has been extremely successful and well received by the international markets. More recently, in the third quarter of 2007, GIC initiated the process of issuing a Malaysian Ringgit medium term note, with the objective of further diversifying funding sources. The launch of the Ringgit 1 billion note is in advanced stages and expected to be completed in the first quarter of 2008. The AAA rating assigned to GIC by Rating Agency Malaysia (RAM) is likely to favor the corporation in securing competitive pricing and strengthen its relationships in that region.

The table below provides the breakdown of the Corporation's funding source for the comparative years 2006 to 2007.

	2007 (US\$ millions)	2007 (%)	2006 (US\$ millions)	2006 (%)
GCC Deposits	2,326	25%	1,745	22%
International Deposits	478	5%	387	5%
Repo Financing	2,372	26%	1,836	23%
Term Financing	1,808	20%	2,046	25%
Shareholder's funds & Others	2,164	24%	2,099	25%
<b>Total</b>	<b>9,148</b>	<b>100.0%</b>	<b>8,113</b>	<b>100.0%</b>

### Contingency Funding Plan

Within GIC, liquidity is managed through a well-defined process to ensure that all funding requirements will be met properly. This process includes establishment of an appropriate contingency funding plan (CFP).

GIC's CFP prepares the Corporation for the unlikely event of a liquidity crisis caused by material changes in the financial market conditions, including credit rating downgrades. CFP procedures are articulated clearly in the Corporation's Liquidity Policy Document. The procedures include:

- a) a variety of measures to be undertaken in the absence of liquidity crisis to enhance GIC's available liquidity in the event of a crisis;
- b) identify specific triggers that will prompt activation of CFP; and
- c) specific guidelines for the management of liquidity crisis.

### Interest Rate Risk Gapping Limit

Treasury manages short-term interest rate gapping by means of monitoring overall interest rate exposure in the next twenty-four (24) months as measured in Eurodollar futures contract equivalents. It is widely accepted that the rate calculated from short-dated (up to 2 years) Eurodollar futures contract is effectively the forward interest rate of the underlying. Any funding, placements or borrowing that has a maturity or re-pricing of over two (2) years are either matched or hedged.



Since GIC also runs gapping positions in other major currencies apart from the USD, the gaps on these currency positions are translated to USD equivalents in order to ascertain the equivalent number of Eurodollar futures contract.

The Eurodollar futures contract, given its liquidity, is a reasonable proxy to gauge interest rate risk on the short-term funding gap. The rationale behind this type of measurement is, if necessary, positive (negative) gaps within a given time bucket could be covered by selling (buying) Eurodollar futures contracts equivalent to the notional amount of the gaps. Potential contracts from individual time buckets are accumulated for each currency and then subsequently aggregated for all major currencies. The maximum number of notional contract is currently set at 3,500.

Treasury is responsible for monitoring and ensuring that potential short-term interest rate risk exposure remains within the authorized limits. However, proper escalation procedures are in place to address temporary and permanent excesses.

#### **Maturity profile of assets and liabilities**

A detailed breakdown of the maturity profile by individual asset and liability category is provided in Note 24 to financial statements. At December 31st 2007, roughly 80% of total assets were due to mature within 3 months, based on internal assessment of the Corporation's right and ability to liquidate these instruments. Comparatively, on the same basis, approximately 50% of total liabilities were in the same time bucket. The sizable portfolio of high quality marketable securities contributed to the relatively high ratio of liquid assets. The corporation's GCC retention record shows that short maturity deposits from GCC governments, central banks and other regional financial institutions have been regularly renewed over the past several years.

#### **Credit Rating**

GIC's long term deposits continue to be rated A- by Standard & Poor's, A2 by Moody's and A by Fitch. GIC is among a select few financial institutions in the region to maintain such high ratings by all three major international agencies. The superior ratings reflect, among other strengths, the corporation's consistently strong track record, ownership and effective management.

During 2007, Rating Agency Malaysia (RAM) assigned GIC a long term rating of AAA, its highest, highlighting in their report GIC's strong ownership and pedigree, healthy fundamentals and sturdy franchise in the region.

	<b>Moody's</b>	<b>Standard &amp; Poor's</b>	<b>Fitch</b>
Long-term Deposits	A2	A-	A
Short-term Deposits	P-1	A-2	F1
Bank Financial Strength (BFSR)	D+	-	

We believe that the Corporation's enhanced rating is indicative of a sound business operation and future business potential.

### **Capital Strength**

Capital represents the shareholder's investment and is a key strategic resource which supports the corporation's risk taking business activities. In line with the corporation's financial objective, management strives to deploy this resource in an efficient and disciplined manner to earn competitive returns. Capital also reflects financial strength and security to the corporation's creditors and depositors. Capital management is fundamental to GIC's risk management philosophy, and takes into account economic and regulatory requirements.

### **Regulatory Capital**

The Basel Committee on Banking Supervision has introduced a revised capital adequacy framework that promotes the adoption of stronger risk management practices, and more risk-sensitive capital requirements that are conceptually sound and at the same time pay due regard to particular features of the present supervisory and accounting systems in individual member countries.

The Central Bank of Kuwait (CBK) had issued a directive for banks in Kuwait to implement the revised accord beginning December 2005. While GIC does not fall under the purview of the CBK, the Corporation finds it prudent to implement the recommendations set forth under the revised accord with the following primary objectives:

- a) The Corporation has been subjecting itself to the standards of Basel 1 (1988) and the amendments introduced in 1998 (market risk). As a natural progression, adoption of the modified standards as outlined in the revised capital accord underscores the Corporation's commitment to be in line with international standards;

- b) GIC acknowledges the importance of the qualitative and quantitative approaches set out in Basel 2 that impose rigor and discipline with respect to capital adequacy assessment; and
- c) Adopting the Basel 2 capital accord is viewed to enhance risk culture within the organization and further strengthen GIC's market image, thus, resulting to improvements in external credit ratings assigned by international rating agencies, thereby ensuring continued access to capital markets.

Under the new accord, the Corporation's Total capital ratio at the end of December 2007 was 18.58%. The Tier 1 ratio was the same, since the existing small quantum of Tier 2 capital was reduced to nil after deductions. The structured standardized approach was used to calculate the capital requirement to cover credit and operational risks. Market risk capital cover calculation, on the other hand, employed the VaR-based approach. Going forward, GIC aims to achieve convergence of regulatory capital with economic capital as it adopts more advanced measurements for capital adequacy. Details of the regulatory capital ratio computations are provided in the Basel 2 disclosure section of this annual report.

#### **Economic Capital**

In addition to maintaining capital reserves based on regulatory requirements, economic capital sufficiency based on internal models is also determined. The economic capital computation process has three fundamental objectives: determine economic capital sufficiency, in addition to regulatory capital adequacy; assist in equitable / standardized performance measurement of businesses, on a 'real' (risk adjusted) basis; and assist in optimizing resource allocation to achieve target risk adjusted ROE for the corporation.

Economic capital is a measure of risk and can be defined as the amount of capital required to cover unexpected losses, arising from doing business. It is the amount of capital that is required to achieve equilibrium between expected return and risk of bankruptcy. The need for economic capital arises due to the uncertainty of positive returns and or future cash flows. For each asset/exposure, portfolio, business unit, group and entity, economic capital reflects the quantification of the unexpected loss amounts arising from the four principal risk forms: Credit risk, Market risk, Liquidity risk and Operational risk.

#### **Operational Risk**

The introduction and implementation of the new accord transcends operational risk management into a serious emerging issue for the regulators and financial institutions alike. Operational risk is defined by GIC as the risk of loss to earnings or capital arising from inadequate or failed internal processes, people or systems or from external events. This definition clearly includes disaster recovery planning as another element of operational risk management. It is for this reason that the Corporation finds it prudent to include the same consideration – namely, unexpected significant and unusual one-time events, such as disaster events - in its framework for operational risk management.

GIC already has a strong internal control culture and a good information system that assist in the timely identification and resolution of material operational risks. There are existing policies and procedures that address operational risk issues relating to procedures and systems controls.

Among these controls are:

- a) appropriate segregation of duties by adopting the "checker-maker" concept in operating procedures;
- b) the scheduled reconciliation processes to identify unusual items;
- c) the implementation of system security controls;
- d) periodic internal audit due diligence to verify that operating policies and procedures have been implemented effectively;
- e) suitable insurance coverage remains valid to mitigate operational losses; and
- f) the formulation of a comprehensive Disaster Recovery Plan (DRP) and Business Continuity Plans (BCPs).
- g) a sound framework for operational risk reporting.

Since the Corporation plans to graduate to a more advance level (the Advance Measurement Approach or AMA) in calculating operational risk capital requirement, a more disciplined "bottom-up" method will be adopted whereby the approach is anchored on objective loss data. To implement such an approach, a four-stage progression will be followed:

#### **Stage 1 - Operational risk self assessment (ORSA)**

This will involve qualitative review of inherent operational risks, assessment of controls and

procedures, and specification of corrective actions if necessary and follow-up on implementation of such actions.

The self-assessment process involves line management in each business and operating units that allows for comfortable participation and frank open communication between the line managers and the operational risk managers. ORSA is likewise seen to train line managers to consciously be aware of potential operational risks that may occur in their respective areas of responsibilities.

#### **Stage 2 - Identification and loss data collection**

This will entail mapping out the risk inherent in the business that must be consistent with the scope of operational risk defined under the revised capital accord (Basel 2). The internal losses will be tracked in accordance with the seven (7) loss event types criteria set out by Basel 2, namely:

- a) internal fraud
- b) external fraud
- c) execution, delivery and process management
- d) clients, products, and business practices
- e) employment practices and workplace safety
- f) business disruptions and failures
- g) damage to physical assets

#### **Stage 3 - Developing metrics and Key Risk Indicators (KRIs)**

Indicators (KRIs). Developing KRIs is the process of collecting and reporting on an eclectic set of quantitative measures that correlate with the likelihood of potential failures in a process. KRIs will be examined in combination with loss data.


#### **Stage 4 - Measurement or Analytics**

Analytics relates to quantitative analysis applicable to fragmentary data of very low probability but very high impact loss events. The aim at this level is to allow GIC to manage operational risk and measure internally the capital requirement, compliant with the Advanced Measurement Approaches (AMA) recommended by Basel 2. In general, the objective is to estimate a loss distribution and to derive functions of interest from it, such as value-at-risk (VaR).

Throughout the 4 stages, results will be consolidated and the ORM process will be continuously improved. This qualitative to quantitative approach to operational risk may take some time, but the immediate benefits derived in terms of ORM improvement and better operational risk awareness will be worth the exercise.

# Basel 2 Disclosure





## Basel 2 Rationale: Aligning banking risk management with capital requirements

As Basel 2 continues to evolve, the Basel Committee moves closer to its goal of aligning banking risk and its management with capital requirements. The primary objective of the new accord is to improve safety and soundness in the financial system by placing increased emphasis on bank's internal controls and risk management processes and models, the supervisory review process, and market discipline.

Basel 2 Rationale:

**Aligning banking risk management with capital requirements** *(continued)*

While the 1988 Capital Accord addressed market and credit risks, Basel 2 substantially changes the treatment of credit risk and also requires that banks have sufficient capital to cover operational risk. Compliance to the accord requires gathering extensive data in order to implement a comprehensive risk framework across the institution. As such, this would likely have wide-ranging effects on a bank's information technology, processes, people and business – beyond regulatory compliance and finance functions. Basel 2 also encourages ongoing improvements in risk assessments and mitigation. Thus, over time, it presents banks with the opportunity to gain competitive advantage by allocating capital to business activities that demonstrate a strong risk-return ratio. Developing a better understanding of the risk/reward trade-off for capital supporting specific business or products is one of the most important business benefits banks may derive from compliance to the new accord.

### **The Architecture of Basel 2 –The Three Pillars**

With Basel 2, the Basel Committee abandons Basel 1's 'one-size-fits all' method of calculating minimum regulatory capital requirements and introduced a three-pillar concept that seeks to align regulatory requirements with economic principles of risk management. At the same time, by putting operational risk management on every bank's agenda, Basel 2 encourages a new focus on its management and sound and comprehensive corporate governance practices.

### **The Three Pillars Defined...**

#### **Pillar 1 – Minimum Capital Requirements**

Pillar 1 sets out minimum regulatory capital requirements – meaning the amount of capital banks must hold against risks. The new framework provides a continuum of approaches from basic to advanced methodologies for the measurement of both credit and operational risks. It provides a flexible structure in which banks, subject to supervisory review, will adopt approaches that best fit their level of sophistication and their risk profile. The framework also deliberately builds in rewards for stronger and more accurate risk measurement

#### **Pillar 2 – Supervisory Review**

Pillar 2 defines the process for supervisory review of a bank's risk management framework and ultimately, its capital adequacy. It sets out specific oversight responsibilities for the board and senior management, thus reinforcing principles of internal controls and corporate governance practices. Financial supervisors would be responsible for evaluating how well banks are assessing their capital adequacy needs relative to their risks. Intervention would be exercised, where appropriate.

### **Pillar 3 – Market Discipline**

Pillar 3 aims to bolster market discipline through enhanced disclosure by banks. It sets out disclosure requirements and recommendations in several areas, including the way a bank calculates its capital adequacy and its risks assessment methods. The intended result is enhanced transparency and comparability with other banks.

### **Gulf Investment Corporation G.S.C.**

#### **(GIC or 'the Corporation') – Market Disclosure**

The following sections set out the Corporation's disclosure details prepared in line with the new accord's requirements vide its publication dated June 2006– A Revised Framework for International Convergence of Capital Measurement and Capital Standard.

### **1. Capital Structure**

GIC is an investment company incorporated in the State of Kuwait on November 15, 1983 as a Gulf Shareholding Company. It is equally owned by the governments of the six member states of the Gulf Cooperation Council (GCC), i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. The corporation has no subsidiaries or significant investments in banking, insurance, securities, and other financial entities.

Table 1 presents the Corporation's regulatory capital resources for the years ending December 2007 and December 2006. The definition of regulatory capital under the two accords remains unchanged. However, Basel 2 permits recognition of general provision (albeit subject to a maximum of 1.25% of credit risk weighted assets) as part of Tier 2 capital. Meanwhile, the portion of significant



investments in financial and commercial entities that exceed a certain materiality threshold; and exposures to 'Securitization' that fall below a cut-off risk grade are deducted 50% from Tier 1 and 50% from Tier 2 capital, respectively. For 2007, deduction from Tier 2 capital was limited to the quantum of Tier 2 capital, with a proportionately higher deduction being applied to Tier 1. Total eligible regulatory capital was US\$ 1,557.4 million by year-end December 2007 compared to US\$ 1,780.5 million recorded in December 2006. The decline was primarily due to deductions in capital pertaining to investments in structured products. As a conservative measure, Tier 2 capital includes only 45% of the fair value reserve for investment in projects, securities, funds and alternative assets. Notably, while the new accord is silent on the application of discounts on fair value reserve, GIC elected to apply the same level of discount (i.e. 55%) as contained in the guidelines set by the Central Bank of Kuwait. In keeping with the spirit of the accord, the Corporation feels strongly that application of a discount suggests the possibility of price fluctuations, and as such, a better reflection of the true risk positions.

Table 1: Eligible Regulatory Capital

In US\$ millions	31 December 2007	31 December 2006
Paid-up capital	1,000.0	750.0
Disclosed reserves	453.3	403.3
Retained earnings	301.1	584.3
Less: Goodwill	38.6	39.5
Less: Deductions	158.4	0.2
<b>Total Tier 1 Capital</b>	<b>1,557.4</b>	<b>1,697.9</b>
Fair value reserve	91.4	78.2
General Provision	2.9	4.6
Less: Deductions	94.3	0.2
<b>Total Tier 2 Capital</b>	<b>-</b>	<b>82.6</b>
<b>Total eligible regulatory capital</b>	<b>1,557.4</b>	<b>1,780.5</b>

## 2. Capital Adequacy Management

The corporation's primary guiding principle to its capital adequacy management is to maintain a strong capital base that could support current as well as future growth in business activities, and at the same time, with the objective of maintaining satisfactory capital ratios and high credit ratings.

GIC's process of assessing the capital requirements commences with the compilation of the annual business plan by individual business units which are then consolidated into the annual budget plan of the Corporation. The annual budget plan provides the estimated overall growth in assets, its impact on capital and targeted profitability for the forthcoming fiscal year. Utilizing the financial projections generated from the budget plan, capital is allocated to the various business units in such a way that the allocations remain consistent with the risk profile of the business activity. These capital allocations as well as corresponding RORACs (return on risk-adjusted capital) are reviewed on an ongoing basis during the budget year in order to optimally deploy capital to achieve targeted returns. Whilst the Corporation acknowledges the benefits of higher leverage to ROE (Return on Equity), it also believes in the advantage and benefit of keeping a strong capital position. As such, GIC maintains a prudent balance among the major components of its capital. Current internal policy aims to maintain a floor of 16% total capital adequacy ratio. Annual dividend payout, meanwhile, is prudently determined and proposed by the Board of Directors, endeavoring to meet shareholder expectations while ensuring adequate retention of capital to support organic growth. Finally, the Corporation targets a credit risk rating of single 'A'

or better. This would allow easy access to capital from the market at competitive pricing in the event additional funding needs to be appropriated.

GIC is among a select few financial institutions in the region to maintain such high ratings by all three major international agencies. Details of the corporation's ratings are provided on page 45 of this annual report.

Table 2: Capital Adequacy Ratios

In US\$ millions	Risk-weighted assets	Capital requirement
Credit Risk	5,101.9	408.1
Market Risk	2,299.1	183.9
Operational Risk	980.8	78.5
<b>Total</b>	<b>8,381.8</b>	<b>670.5</b>
Capital Adequacy Ratios		
Total CAR	18.58%	
Tier 1 Ratio	18.58%	

Table 3: Risk Exposure Break-down

In US\$ millions	31 December 2007
<i>Credit Risk (RWA)</i>	
Claims on sovereigns	47.1
Claims on Public Sector Entities	62.5
Claims on Banks	729.4
Claims on Corporates	1,624.0
Securitization and Structured Investment Vehicle	831.1
Venture Capital and Private Equity	282.7
Investments in Commercial Entities	951.5
Investments in Other Funds and Quoted Equities	279.9
Other Assets	293.7
<b>Total</b>	<b>5,101.9</b>
<i>Market Risk (VaR)</i>	
Interest rate risk position	4.0
Foreign exchange risk position	0.9
Equity risk position	25.6
Total VaR x 3	91.5
Specific risk position	92.5
Total capital requirement	183.9
<b>Total RWA (capital requirement x 12.5)</b>	<b>2,299.1</b>
<i>Operational Risk (RWA):</i>	
Operational risk capital charge	78.5
<b>Total RWA (capital charge x 12.5)</b>	<b>980.8</b>

Table 2 details the risk-weighted assets together with their corresponding regulatory capital requirements as at 31 Dec 2007. Total capital adequacy ratio and Tier 1 capital ratio are likewise calculated. The numbers were generated by applying the 'Standardized' approach for credit and operational risks, while the 'Internal Model' approach was utilized to yield market risk positions. Total risk-weighted exposures of US\$ 8,381.8 million, as at end of Dec 2007, requires regulatory capital of US\$ 670.5 million to meet the minimum Basel 2 CAR of 8%. Should the minimum CAR threshold be raised to GIC's internal target of 16%, the required regulatory capital increases to about US\$ 1,341 million. The reported eligible regulatory capital of US\$ 1,557.4 million still provides sufficient cushion to support business expansion.

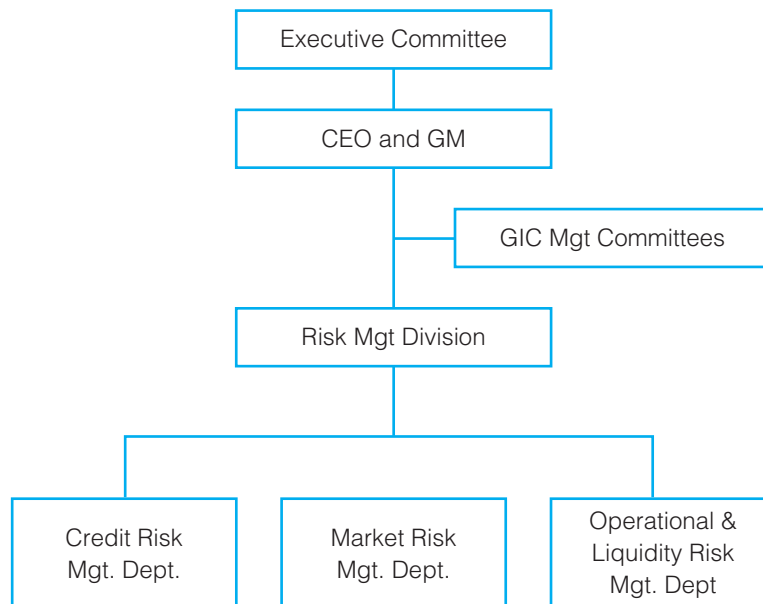
### 3. Risk Management Structure

To address the continuously changing and complex business environment, the Corporation adapts an agile and effective risk management process. Management realizes that not all risks need to be eliminated; however, they need to be systematically identified and measured in order to be properly managed. To this end, the Corporation established an effective risk management structure that enabled a process of achieving an appropriate balance between risk and reward, by optimizing profits and ensuring that GIC is protected from unwarranted exposures that are likely to threaten the viability of the Corporation.

The Corporation's risk management process is an integral part of the organization's culture, and is embedded into the organization's practices as well as in all those involved in the risk management process. The Executive Committee (Execom) of the Board, senior management, risk officers, and line managers contribute to effective enterprise-wide risk management. The Execom defines its expectations, and through its oversight determines its accomplishment. The Board of Directors has ultimate responsibility for risk management as they set the tone and other components of an enterprise risk management. Risk officers have the responsibility for monitoring progress and for assisting line managers in reporting relevant risk information and the line managers are directly responsible for all business risk generated in their respective domains. The effective relationship between these parties

significantly contributes to the improvement in the Corporation's overall risk management practices as this leads to the timely identification of risk and facilitation of appropriate response. The Risk Management Division (RMD) structure has a distinct identity and independence from business units. RMD ensures that risk exposures remain within tolerable levels relative to the Corporation's capital and financial position. The division reports directly to the Chief Executive Officer & General Manager, and is manned by dedicated risk specialists in all disciplines to address the pertinent business risks exposure of the Corporation. Its main responsibilities are to:

- a) Evaluate and analyze the enterprise wide risk profile by developing risk monitoring techniques
- b) Set up and develop criteria for defining the Corporation's risk threshold in terms of various risks
- c) Develop and establish tools for the measurement of the Corporation's various risk types; and
- d) Recommend appropriate strategies/actions for mitigating risk and ensuring a sound risk asset structure for the Corporation. The abridged organizational structure of GIC's risk management structure is shown below:



The following management committees have the responsibility and authority for the day-to-day risk management activities of the Corporation, and where by such authorities are being exercised within the objectives and policies approved by the Executive Committee.

- a) Management Committee (Mancom) covers mainly general management issues including performance review vis-à-vis budget, and assessment of status quo against strategic business plan.
- b) GMG Investment Committee translates investment strategy directions into asset allocation guidelines, recommends investment proposals, and reviews investment portfolios. The committee also functions as a surrogate Asset-Liability Committee.
- c) PI Investment Committee evaluates proposals for investments and divestiture of assets and ensures compliance to investment criteria as well as investment procedures at each phase of the investment process.
- d) GM Product Management Committee identifies product development opportunities, recommends product launches, and monitors performance of same. Product performance and operational issues are resolved in this committee.
- e) Systems Steering Committee provides the forum to discuss functions. The committee likewise reviews the IT architecture and its condition to meet current and future business requirements.
- f) Audit Committee provides assurance on the adequacy of internal controls and accuracy of reports and reporting.
- g) Human Resources Committee, as it relates to risk, covers the staffing levels and succession planning, as well as review of performance and bonus determination.

The risk management objectives, policies, measurement and reporting for the major risk areas, i.e., credit, market, liquidity, operational, interest rate risk are detailed in the 'Risk Management's section. The same section provides for the approach adopted by the Corporation towards management and mitigation of these risks.

#### 4. Credit Risk Exposure

The corporation follows both qualitative and quantitative approaches to credit risk management. These approaches are clearly articulated in the Corporation's Credit Policy Document which aims to promote a strong credit risk management architecture that includes credit procedures and processes. The policy defines the areas and scope of investment activities undertaken by the Corporation and its main goal is not simply to avoid losses, but to ensure achievement of targeted financial results with a high degree of reliability. The corporation's credit risk management focuses on the dynamic and interactive relationship between three credit process phases: Portfolio strategy and planning, investment origination and maintenance, and performance assessment and reporting. Each of these phases is discussed briefly below.

##### **Portfolio Strategy and Planning**

The overall desired financial results, the portfolio strategy of each business unit, and the credit standards required to achieve the targets are defined during the planning phase. The business strategies are developed in such a way that they integrate risk and that they meet the defined hurdles in terms of return on risk adjusted capital (RORAC). Portfolio management establishes composition targets, monitors the results of these diverse business strategies on a continual basis, and allows the Corporation to manage concentrations that can result from seemingly unrelated activities. Specifically, portfolio management involves setting concentration limits by standard dimensions so that no one category of assets or dimension of risk can materially harm the overall performance of the Corporation. The Board has set specific limits for individual borrowers and groups of borrowers and for geographical and industry segments. These limits consider the individual credit of the various counterparties as well as the overall portfolio risk. The Investment Committees approve investment proposals and review portfolio concentrations in terms of economic sectors and asset class. These limits are reviewed annually to ensure that there are no undue concentrations in one sector or asset class, and that the limits are within those set out by the Corporation. For counter-party limits, such as limits for banks and financial institutions, credit line approval follows a strict process of credit review, with proper authority levels delegated to senior credit officers.

Foreign exchange trading and interstate gap limits, together with ancillary limits (e.g., daylight, overnight, stop loss, etc.) are recommended by Treasury for the review of risk management, and eventual approval by the Executive Committee. The Risk Management Division quantifies the Corporation's credit risk appetite inline with the overall strategy. The division employs a process of allocating capital on a portfolio level for the total credit exposure assumed by each business unit. The business units' actual capital consumption is assessed against the budget, and variances are appropriately reported to senior management.

#### **Investment Origination and Maintenance**

The business units solicit, evaluate, and manage credit exposure according to the strategies and portfolio parameters established during the portfolio strategy and planning phase. Investments are generated within well-defined criteria, product structure, and are approved on the basis of risk and return assessment. The processes involved under credit maintenance include documentation review and disbursement, and review of the status of exposures. Within this phase, origination and underwriting for distribution to investors takes place. The business units remain the sponsor and main risk managers of their proposals. While the risk management team independently reviews investment/product proposals prior to granting approvals to ensure that the proposals are within the tolerable risk appetite of the Corporation and are consistent with its policy, prior to disbursement of funds.

#### **Performance Assessment and Reporting**

The performance assessment and reporting phase allow both the Senior Management and business units to monitor results and improve performance continually. Both portfolio and process trends are monitored in order to make appropriate and timely adjustments to business strategies, portfolio parameters, credit policies and investment origination and maintenance practices. This phase of the credit process draws on information within the Corporation and external benchmarks to help evaluate performance. The goal of performance assessment is to achieve a balanced portfolio of assets, well diversified, and generating returns consistent with targets. Credit performance is assessed through analysis of:

- a) Portfolio concentrations by obligor, industry, risk rating, maturity, asset class, as well as other dimensions.

- b) Generated return on capital employed (RORAC)
- c) Additional economic value created by individual projects.
- d) Exceptions to risk acceptance criteria; and
- e) Other policy exceptions.

Inherent in the Corporation's business activity is the presence of 'portfolio risk', which arises whenever there is high positive correlation between individual credit portfolios. To address this particular risk, the Corporation employs the 'Credit Manager' system promoted by the Risk Metrics Group. The system is a quantitative based program where overall portfolio 'Credit Value at Risk' is measured and controlled. This model calculates Credit VAR based on credit ratings of the names, default probabilities, loss given default, current market prices of the credits, while considering the impact of correlation of the various credits in the portfolio. In order to institute a common language for understanding and dimensioning credit risk across GIC's range of investments in projects, Risk Management Division is in the process of developing an internal credit risk rating (ICRR) model that would assist management in determining level of capital allocation and other strategic schemes applicable to the investment credit rating. Naturally, the model will also be used to benchmark the required return given a particular level of risk. Additionally, the rating results will subsequently be used as valuable inputs into the 'Credit Manager' system mentioned above.

#### **Credit Risk as per Basel 2 Standardized Approach**

Under the credit risk 'Standardized' approach, credit exposures are categorized to standard portfolios that are subject to a distinctive risk-weighting scale based on standard characteristics of the nature of borrower as well as the external credit assessments of international rating agencies where available. GIC uses the credit ratings assigned by Moody's, S&P and Fitch for this purpose. When more than one counter-party rating is available, Basel 2's multiple assessment guidelines are invoked. In order to provide a common platform into which different notations used by the aforementioned rating agencies can be mapped, a scale of uniform Credit Quality Grades (CQG) represented by the numerals 1 to 5 or 6 are used to represent the relevant risk weights of each standard portfolio. Separate

scales are prepared for risk-weighting both long-and short-term issues. Table 4 serves as a sample of mapping notations of rating agencies into CQGs for claims on Corporates. At December 31, 2007, rated credit exposures accounted for more than 50% of total credit exposures. Note that the numbers are after applying the equivalent risk-weights (credit conversion) as provided under the Basel 2 accord. Meanwhile, gross credit exposure to rated assets was recorded at approximately 67% of total gross credit exposure. Assets that are rated single 'A' or better comprised 76% of rated gross credit exposure. Tables 5 and 6 present the breakdown of credit exposures pre and post-credit conversion. In terms of facility type (Table 7), US\$ 7,744.2 million or approximately

92% is funded. The balance is ascribed to guarantees issued and commitments made by the Corporation, as well as credit exposures on outstanding forward and swap transactions with banks. The geographical distribution (Table 8) is based on either the primary purpose of the exposure or the place of incorporation of the debt security issuer, or incorporation of fund manager. A sizable portion of credit exposure is in the GCC region tallying at US\$ 3,716.4 million, or 44.1% of the total. Following suit are exposures to Europe and North America, 27.7% and 26.7% respectively. These exposures are due in great part to investments in global securities and funds with varying investment themes.

Table 4: CQG Mapping

Corporates Credit Quality Grades	S&P	Moody's	Fitch
1	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
2	A+	A1	A+
	A	A2	A
	A-	A3	A-
3	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
4	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
5	B+	B1	B+
	B	B2	B
	B-	B3	B-
6	CCC+	Caa1	CCC+
	CCC	Caa2	CCC
	CCC-	Caa3	CCC-
	CC	Ca	CC
	C	C	C
	D		D

Table 5: Credit Exposure (Post - Credit Conversion)

In US\$ millions	31 Dec 2007		
	Rated	Unrated	Total
Claims on Sovereigns	47.1		47.1
Claims on Public Sector Entities	62.5		62.5
Claims on Banks	729.4		729.4
Claims on Corporate	916.5	707.5	1,624.0
Securitization and SIVs	831.1	(deduction from capital)	831.1
Venture Capital and Private Equity		282.7	282.7
Investments in Commercial Entities		951.5	951.5
Other Funds and Quoted Equities		279.9	279.9
Other Assets		293.7	293.7
<b>Total</b>	<b>2,586.6</b>	<b>2,515.3</b>	<b>5,101.9</b>
In Percent	50.7%	49.3%	100.0%

Table 6: Gross Credit Exposure (Pre-Credit Conversion)

In US\$ millions	31 Dec 2007		
	Rated	Unrated	Total
Claims on Sovereigns	420.4	-	420.4
Claims on Public Sector Entities	139.7	-	139.7
Claims on Banks	1,860.6	-	1,860.6
Claims on Corporate	1,553.0	707.6	2,260.6
Securitization and SIVs	1,636.4	252.7	1,889.1
Venture Capital and Private Equity		282.7	282.7
Investments in Commercial Entities		951.5	951.5
Other Funds and Quoted Equities		279.9	279.9
Other Assets		348.8	348.8
<b>Total</b>	<b>5,610.1</b>	<b>2,823.2</b>	<b>8,433.3</b>
In Percent	66.5%	33.5%	100.0%



Table 7: Gross Credit Exposure before CRM

In US\$ millions	31 Dec 2007		
	Funded	Unfunded	Total
Claims on Sovereigns	420.4		420.4
Claims on Public Sector Entities	139.7		139.7
Claims on Banks	1,828.7	31.9	1,860.6
Claims on Corporate	1,603.4	657.2	2,260.6
Securitization and SIVs	1,889.1		1,889.1
Venture Capital and Private Equity	282.7		282.7
Investments in Commercial Entities	951.5		951.5
Other Funds and Quoted Equities	279.9		279.9
Other Assets	348.8		348.8
<b>Total</b>	<b>7,744.2</b>	<b>689.1</b>	<b>8,433.3</b>
In Percent	91.8%	8.2%	100.0%

Table 8: Gross Credit Exposure by Geographic Distribution

In US\$ millions	31 Dec 2007					
	GCC	Other Mena	Europe	North America	Asia	Total
Claims on Sovereigns	420.4	-	-	-	-	420.4
Claims on Public Sector Entities	139.7	-	-	-	-	139.7
Claims on Banks	979.7	-	589.7	242.8	48.4	1,860.6
Claims on Corporate	659.6	-	727.9	818.7	54.4	2,260.6
Securitization and SIVs	-	-	907.4	958.7	23.0	1,889.1
Venture Capital and Private Equity	31.4	-	78.0	170.0	3.2	282.7
Investments in Commercial Entities	931.5	-		20.0		951.5
Other Funds and Quoted Equities	279.9					279.9
Other Assets	274.2		30.6	44.1		348.8
<b>Total</b>	<b>3,716.4</b>	<b>-</b>	<b>2,333.6</b>	<b>2,254.3</b>	<b>129.0</b>	<b>8,433.3</b>
In Percent	44.1%	0.0%	27.7%	26.7%	1.5%	100.0%

Table 9: Gross Credit Exposure by Industry Sector

In US\$ millions	31 Dec 2007					
	Banks & FIs	Trading & Mftg.	Utilities	Govt. Agencies	Other	Total
Claims on Sovereigns				420.4		420.4
Claims on Public Sector Entities				139.7		139.7
Claims on Banks	1,860.6					1,860.6
Claims on Corporate	1,205.1	513.0	405.7		136.8	2,260.6
Securitization and SIVs	1,889.1					1,889.1
Venture Capital and Private Equity	282.7					282.7
Investments in Commercial Entities	77.6	743.8	101.2		28.9	951.5
Other Funds and Quoted Equities	279.9					279.9
Other Assets	214.1			8.2	126.5	348.8
<b>Total</b>	<b>5,809.1</b>	<b>1,256.8</b>	<b>506.9</b>	<b>568.3</b>	<b>292.2</b>	<b>8,433.3</b>
In Percent	68.9%	14.9%	6.0%	6.7%	3.5%	100.0%

Table 10: Credit Exposure by Residual Contractual Maturity

In US\$ millions	31 Dec 2007				
	Within 3 months.	3 months to 1 year	1 to 5 years	Over 5 years	Total
Claims on Sovereigns	189.3	47.1	184.0	-	420.4
Claims on Public Sector Entities			48.9	90.8	139.7
Claims on Banks	899.7	77.7	696.9	186.3	1,860.6
Claims on Corporate	133.4	184.4	834.8	1,108.0	2,260.6
Securitization and SIVs	147.4	49.0	1,040.1	652.6	1,889.1
Venture Capital and Private Equity			4.1	278.6	282.7
Investments in Commercial Entities				951.5	951.5
Other Funds and Quoted Equities				279.9	279.9
Other Assets	137.5	90.0	27.3	94.0	348.8
<b>Total</b>	<b>1,507.3</b>	<b>448.2</b>	<b>2,836.1</b>	<b>3,641.7</b>	<b>8,433.3</b>
In Percent	17.9%	5.3%	33.6%	43.2%	100.0%

Table 11: Credit Exposure on Securitization and SIV's

In US\$ millions	31 Dec 2007	
	Gross Exposure	Post-credit Conversion
CQG 1	810.3	162.0
CQG 2	314.2	157.1
CQG 3	511.9	511.9
CQG 4	0.0	0.1
CQG 5		
CQG 6		
Unrated	252.7	(deduction from capital)
<b>Total</b>	<b>1,889.1</b>	<b>831.1</b>

The table on industry distribution (Table 9) of the gross credit exposure reveals a concentration on banks and financial institutions, amounting to 68.9% of total exposure. Again, this is traced to the Corporation's debt securities and fund investments as it diversifies its asset from purely equity holdings. Meanwhile, inline with GCC's commitment to support the industrial growth within the GCC region, equity investments in commercial entities are focused in the trading and manufacturing sectors. The residual maturity of gross credit exposure broken down by standard credit risk exposure is shown in Table 10. More than 43% of gross credit exposure falls within the longest time bucket of over five years. The one to five year bucket follows closely with approximately 34%.

#### Recognition of Impairment of Assets

The Corporation assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired. Investments are treated as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires considerable judgment. In addition, the Corporation evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for projects and unquoted equities. The corporation reviews its problem loans and advances, and investment in debt instruments at each reporting date to assess whether a provision for impairment should be recorded in the statement of income. In particular, considerable judgment by management is required in the estimation of the amount and

timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions. Noteworthy, the Corporation has taken a strategic decision to wind down its lending activities. An insignificant amount of impaired assets stemming from project loans provided to two manufacturing companies based in the GCC has been fully provided for.

#### 5. Securitization Activities

The Corporation's securitization exposure comes by way of its investments in structured products, which can be generally classified under synthetic securitization. Capital cover treatment of securitization exposures follows the 'Ratings Based' approach as recommended in the Basel 2 capital adequacy guidelines. As such, the external credit assessments provided by either Moody's or S&P are considered when determining credit risk weights for securitization exposures. Table 11 provides the credit rating breakdown of the Corporation's investment in securitization and structured investment vehicles (SIVs): Exposures that are rated CQG 5 and lower are deducted directly from regulatory capital.

## 6. Market Risk

Market risk is measured monitored and managed, both on a notional basis, and using a Market Value at Risk (Market VaR) concept. Quantitative statistical methods combined with judgment and experience are used to effectively manage market risk. The VaR measure of market risk is computed separately for the 'Trading' portfolio, and the combined 'Trading' and 'Investment' portfolios. This section focuses on the VaR measurement for the 'Trading' book, specifically pertaining to regulatory capital adequacy computations. More details are provided in the Risk Management section of the annual report. The regulatory capital adequacy ratios are computed incorporating capital charges for market risk, as per the 1996 Basel Committee amendment to the Capital Accord. GIC follows the Internal Models Approach (IMA) to quantify the capital charge associated with market risk within the trading portfolio.

The corporation uses the 'RiskManager' system, developed by Risk Metrics Group, and utilizes a parametric computational method based on the variance – covariance concept. The Value at Risk (VaR) system was first implemented in 1997, and was regularly upgraded over the years. In line with the capital accord, the parameters used in determining the VaR are a 10 day holding period and 99% confidence level. The computation utilizes an equally weighted historical data set going back one year. The computation ignores the correlation benefit amongst the three risk types (interest rate, equity and foreign exchange), with Total VaR (market risk) being equal to the arithmetic sum of the three components. The capital charge relating to market risk is determined for all portfolios categorized as trading (the trading book), which includes the following (Ref Notes 5 and 6 of 2007 financial statements):

	US\$ Millions
Trading Securities	431.1
Hedge & Alternative Funds Portfolio	660.6
Interest Bearing (Trading) Portfolio	196.8
	1,288.5

Policies relating to recognition, classification, fair value measurement and gain/loss computation are detailed in Note 2.6 of financial statements. GIC believes that it is prudent to provide an explicit capital cushion for price risks to which it is exposed. Such risk of loss arising from the adverse

changes in market variables is predominantly within the trading book. Within the Corporation, capital charge for market risk comprises three main categories: interest rate risk and equity risk (within the trading book) and foreign exchange risk for the entire Corporation.

The Value at Risk concept is a sound basis for the quantification of market risk, and the variance – co-variance methodology adequately suits the Corporation's asset types. Most of the exposures within the trading book entail very little optionality and are mostly linear in nature. The VaR based system provides a dynamic measure of market risk capturing, in a timely manner, the impact of changes in environment on the value of the portfolio of financial instruments. The VaR model is a statistical tool, based on simplifying assumptions, and as such has certain limitations (examples: occurrence of 'fat tails', non-normal distributions and even risks; the past not being a good approximation of future, etc). To a large extent, these limitations are addressed by the back-testing exercise and related multiplication factor used. For all the portfolios within the trading book, the same variance – co-variance methodology is used to compute VaR, which is computed on a daily basis as per the parameters described above.

Scenario analysis and stress testing is an essential component of the market risk management framework. The assumption of normality on which the statistical models are based may become invalid due to the occurrence of certain events. Future scenarios, which result in a breakdown of the historical behavior and relationships between risk constituents, are projected, and potential loss amounts are determined. Most of these scenarios are derived from macroeconomic events of the past, modified with the expectations for the future.

**Back-testing**

The objective of 'Back-testing' is to measure/validate the accuracy of the internal VaR model. Back-testing essentially deals with the process of comparing actual trading results with the model generated risk measures (estimates). Back-testing is conducted in line with the 'Supervisory Framework Document' issued by the Basel Committee. The parameters for back testing are a one-day holding period and 99% confidence level. To the extent that the back-testing program is viewed purely as a statistical test of the integrity of the calculation of Value-at Risk (VaR) measure, the Corporation felt it appropriate to utilize the 'hypothetical portfolio' approach. In this approach, a static hypothetical model portfolio, with similar characteristics of the actual portfolio, is created and daily change in market value is computed based on actual price observations. VaR is also computed for this static portfolio using the model and comparisons are made between actual results and model estimates. The advantage of this method is that the value change outcomes are not 'contaminated' by changes in the portfolio (which could happen if the actual portfolio were used). Based on the results of back testing conducted, the VaR model and concept used to quantify market risk was found to be reasonably accurate, being categorized within the 'Green Zone'. As a result, a multiplication factor of 3 is used, in line with the Basel guidelines.

Capital charge for market risk is determined based on the following formula:

$$\text{Capital Charge (market risk)} = \text{Max} \{V_{avg}, V_{end}\} \times M_f$$

Where,  $V_{avg}$  equals: Average Total VaR for the trading book over the previous 60 business days

$V_{end}$  equals: End of period Total VaR for the trading book

$M_f$  equals: Multiplication factor (a factor of three is used based on the results of back-testing)

Table 12: Trading Book VaR (US\$ 000's) – 10 day holding period, 99% confidence level.

For the last 60 business days in 2007

In US\$ millions	Interest Rate	Equity	FX	Total
Max	4.2	28.8	1.5	31.7
Min	0.7	22.3	0.9	24.2
Average	0.7	26.0	1.2	28.5
31 Dec 07	4.0	25.6	0.9	30.5

## 7. Operational Risk

Operational risk is defined by GIC as the risk of direct and indirect loss resulting from inadequate or failed internal processes, people or systems or from external events. The corporation currently adopts the 'Standardized' approach in the estimation of regulatory capital to support potential operational risk exposure. This approach could be described as a 'bottom-up' method as it goes to the level of each business line within the Corporation. In keeping with the Accord's guidelines, gross income for each business line is determined using the transfer pricing methodology being employed by the Corporation. The identified business lines as well as its major business segments are presented in Table 13.

Table 13: Business Lines for Operational Risk

Business lines	Major business segments	Activity Groups
Principal Investments	Investment and Equity Participation	Venture Capital, Greenfield Investments, Mergers and acquisitions, Privatizations, Equity Participation, IPOs, Secondary Private Placements
Debt Capital Markets	Investments of debt securities	International Corporate Securities, Sovereign Debts, GCC Issues/Bonds, Convertible Bonds, Islamic Bonds, ABSs, FRNs
Equity Investments	Portfolio of investments in equity funds and proprietary funds	Gulf Equities, Equity Portfolios
Alternative Investments	Portfolio of investments in an array of different asset classes and managed funds	Hedge Funds, SIVs, Real Estate, Structured Finance, Islamic Funds, Managed Funds, MBSs, Private Equity, Credit Funds
Treasury	Sales	Fixed Income, Equity, Foreign Exchanges, Commodities, Credit, Funding, Own Position Securities, Lending and Repos, Derivatives
	Market Making	
	Proprietary Positions	
Corporate Finance	Merchant Banking	Mergers and Acquisitions, Underwriting, Privatizations, Research, Debt (Government, High Yield), Syndications, IPO, Secondary Private Placements
	Advisory Services	
Asset Management	Discretionary Fund Management	Pooled, Segregated, Retail, Institutional, Closed, Open
	Non-Discretionary Fund Management	Pooled, Segregated, Retail, Institution, Closed, Open
Head-quarters	Income classified for Head-quarters as per internal FTP (Fund Transfer Pricing) method, and other income that cannot be classified in any other business line	Income from Free Capital, Rental Income, Other Income, etc

Capital risk charge for each business line is computed and reported on a quarterly basis. The capital requirement for each business line and the corresponding capital charge are in Table 14. The highest beta factor of 18% is applied on all business lines save for the 'Asset Management' business line, where a beta factor of 12% is used as suggested in the new capital accord.

The Corporation realizes that the accord offers a continuum of approaches from the simplest basic indicator approach to the more advanced measurement approaches. In its endeavor to adopt a more risk-sensitive approach to operational risk capital management, the Corporation plans to implement a more disciplined 'bottom-up' method whereby the approach is anchored on Objective loss data. To implement such an approach, a four-stage progression will be followed:

- Stage 1 – Operational Risk Self Assessment (ORSA).
- Stage 2 – Identification and Loss Data Collection.
- Stage 3 – Developing Metrics and Key Risk Indicators (KRIs).
- Stage 4 – Measurement or Analytics.

Brief comments on each stage have been provided in the 'Risk Management' section of the annual report.

## 8. Equity Risk in the Banking Book

Equity investments in the banking book are classified at the time of acquisition into those acquired for realizing capital gains and to those purchased for strategic investments. The decision where to classify investments is arrived at after considering significant factors that include business and strategic advantages to the Corporation, and the amount of planned investments. All investment decisions require the approval of the Investment Committees, or the Executive Committee, depending on the amount of exposure. Investments acquired with a view to generating income and profits from capital appreciation are reviewed periodically and disposed off at opportune instances. Meanwhile, the strategic investment portfolios are reviewed based on the industry, market and economic developments, and the Corporation decides whether to liquidate or further consolidate its holdings in these investments. In accordance with International Financial Reporting Standards, equity positions in the banking book are classified as available for sale securities. These invest-

ments are fair valued periodically and revaluation gains/losses are accounted as cumulative changes in fair value in equity. For equity investments quoted in organized financial markets, fair value is determined by reference to quoted bid prices. Fair values of unquoted equity investments are determined by reference to the market value of a similar investment, or the expected discounted cash flows, or other appropriate valuation models. Equity investments whose fair value cannot be estimated accurately are carried at cost less impairment, if any. More details on the accounting treatment of equity investments can be found under 'Significant Accounting Policies' in the financial statements section.

Publicly traded investments represent quoted equities traded in the local and international stock exchanges. Privately held investments represent investments in unquoted entities and projects. The total value of equity investments in the banking book at the end of December 2007 is US\$ 1,194.2 million, net of provision (refer to Table 15). Cumulative realized gain from sale or exchange of available for sale securities and projects is approximately US\$ 134 million, of which a significant portion is from publicly traded equity holdings. Meanwhile, the total un-realized gain recognized in equity is US\$ 229.6 million, of which US\$ 103.2 million is included in Tier 2 capital for capital adequacy calculation purposes.

## 9. Interest Rate Risk in the Banking Book

Treasury manages short term interest rate gapping by means of monitoring overall interest rate exposure in the next 24 months as measured in Eurodollar futures contract equivalents. Treasury is not allowed to mismatch positions over two years unless appropriate management approval has been obtained. Any funding, placements or borrowing that has a maturity or re-pricing profile of more than two years are either matched or hedged. The rate calculated from short-dated (up to two years) Eurodollar futures contract is effectively the forward interest rate of the underlying, i.e. Eurodollar deposits. Total USD placements and borrowings transacted by Treasury are profiled in time buckets from one week and then monthly thereafter until 24 months. The same procedure is applied to other the gaps on these currency positions are translated to USD equivalents in order to ascertain the equivalent number of Eurodollar futures contracts for the individual major currencies.

A maximum limit of 3,500 Eurodollar contracts is currently set, with the maximum VaR at USD2.8MM. The calculation of VaR equivalent is derived from the 90-day average of historical 30-futures contracts yield. The current yield is adjusted by the average volatility before it is applied on the position value. The resulting number is then scaled up to a 95% level of confidence.

The Eurodollar futures contract position value as at December 31, 2007 is calculated at 1,771 contracts, with an estimated VaR of US\$ 3 million. The 31st December 2007 VaR was significantly higher than normal, due to the spike in the volatilities during the last two weeks of the year.

Table 14: Operational Risk Capital Charge

In US\$ millions	31 Dec 2007		
	3 yr Average Gross Income	Beta Factor	Capital Charge
Principal Investment	178.2	18%	32.1
Debt Capital Market	33.2	18%	6.0
Equities Investments	27.1	18%	4.9
Alternative Investments	95.0	18%	17.1
Treasury	11.0	18%	2.0
Asset management	20.2	12%	2.4
Corporate Finance	8.5	18%	1.5
Head-quarters	69.3	18%	12.5
<b>Total</b>	<b>442.6</b>		<b>78.5</b>
Risk-weighted exposure			980.8

Table 15: Equity Holdings in Banking Book

In US\$ millions	31 Dec 2007		
	Publicly Traded	Privately Held	Total
Fair Value of Equity Investments	741.7	452.5	1,194.2
Realized gains recorded in P/L	130.3	3.9	134.2
Unrealized gains recorded in equity	207.0	22.6	229.6
45% of unrealized gains in Tier 2 capital	93.1	10.1	103.2



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## **Independent Auditors' Report to the Shareholders of Gulf Investment Corporation G.S.C.**

We have audited the accompanying financial statements of Gulf Investment Corporation G.S.C. ('the Corporation') which comprise the balance sheet as at 31 December 2007 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion the financial statements give a true and fair view of the financial position of the Corporation as of 31 December 2007 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

### **Report on other legal and regulatory requirements**

Furthermore, in our opinion, proper books of account have been kept by the Corporation and the financial statements, together with the contents of the report of the Directors relating to these financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the financial statements incorporate all information that is required by the Commercial Companies Law of 1960, as amended, and by the Corporation's articles and memorandum of association, and that to the best of our knowledge and belief, no violations of the Commercial Companies Law of 1960, as amended, nor of the Corporation's articles and memorandum of association have occurred during the year ended 31 December 2007 that might have had a material effect on the business of the Corporation or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organization of banking business, and its related regulations during the year ended 31 December 2007.



ERNST & YOUNG  
Kuwait  
20 February 2008

## Balance Sheet

As at 31 December 2007

(US\$ million)	Note	2007	2006
<b>Assets</b>			
Cash and cash equivalents		9	4
Placements	3	623	648
Securities purchased under resale agreements	4	186	14
Interest bearing securities and funds	5, 17	5,187	4,746
Equities and managed funds	6, 17	1,387	1,154
Loans	7	40	17
Private equity funds	8, 17	305	226
Investment in project held for sale	9	-	198
Investment in projects and equity participations	10, 17	1,078	879
Property and other fixed assets	11	18	20
Other assets	12	315	207
<b>Total assets</b>		<b>9,148</b>	<b>8,113</b>
<b>Liabilities and equity</b>			
<b>Liabilities</b>			
Deposits	13	2,804	2,132
Securities sold under repurchase agreements	4	2,372	1,836
Term finance	14	1,808	2,046
Other liabilities	15	206	188
<b>Total liabilities</b>		<b>7,190</b>	<b>6,202</b>
<b>Equity</b>			
Share capital		1,000	750
Reserves		657	577
Retained earnings		301	584
<b>Total equity</b>	16	<b>1,958</b>	<b>1,911</b>
<b>Total liabilities and equity</b>		<b>9,148</b>	<b>8,113</b>

The accompanying notes form an integral part of these financial statements.

**Dr. Yousef Hamad Al-Ebraheem**  
Chairman

**Hisham Abdulrazzaq Al-Razuqi**  
Chief Executive Officer and General Manager

## Statement of Income

For the year ended 31 December 2007

(US\$ million)	Note	2007	2006
Interest and similar income	18	308	254
Investment and fee income	19	472	576
Total income		780	830
Interest and similar expenses	20	(332)	(280)
<b>Gross operating income</b>		<b>448</b>	<b>550</b>
Income from recovery of debt	21	103	111
Provisions/ impairment losses	22	(246)	(5)
Staff cost		(39)	(34)
Premises cost		(1)	(4)
Other operating expense		(12)	(18)
<b>Net income for the year</b>		<b>253</b>	<b>600</b>

The accompanying notes form an integral part of these financial statements.

## Statement of Changes in Equity

For the year ended 31 December 2007

(US\$ million)	Reserves					Total
	Share capital	Compulsory reserve	Voluntary reserve	Investment revaluation reserve	Retained earnings	
Balance as at 1 January 2006	750	207	77	327	281	1,642
Net gains on disposal of available for sale investments transferred to income statement	-	-	-	(165)	-	(165)
Change in fair value of available for sale investments	-	-	-	10	-	10
Share of investment revaluation reserves of associated companies	-	-	-	1	-	1
Total income and expenses for the year recognised directly in equity	-	-	-	(154)	-	(154)
Net income for the year	-	-	-	-	600	600
Total income for the year	-	-	-	(154)	600	446
Transfer to compulsory reserve	-	60	-	-	(60)	-
Transfer to voluntary reserve	-	-	60	-	(60)	-
Dividend for 2005 (note 24)	-	-	-	-	(177)	(177)
Balance as at 31 December 2006	750	267	137	173	584	1,911
Balance as at 1 January 2007	750	267	137	173	584	1,911
Net gains on disposal of available for sale investments transferred to income statement	-	-	-	(233)	-	(233)
Transfer of associates revaluation gain to income statement on disposal	-	-	-	(10)	-	(10)
Change in fair value of available for sale investments	-	-	-	251	-	251
Share of investment revaluation reserves of associated companies	-	-	-	22	-	22
Total income and expenses for the year recognised directly in equity	-	-	-	30	-	30
Net income for the year	-	-	-	-	253	253
Total income for the year	-	-	-	30	253	283
Transfer to share capital (note 16)	250	-	-	-	(250)	-
Transfer to compulsory reserve	-	25	-	-	(25)	-
Transfer to voluntary reserve	-	-	25	-	(25)	-
Dividend for 2006 (note 24)	-	-	-	-	(236)	(236)
<b>Balance as at 31 December 2007</b>	<b>1,000</b>	<b>292</b>	<b>162</b>	<b>203</b>	<b>301</b>	<b>1,958</b>

The accompanying notes form an integral part of these financial statements.

## Statement of Cash Flows

For the year ended 31 December 2007

(US\$ million)	Note	2007	2006
<b>Cash flows from operating activities:</b>			
Net income for the year		253	600
Adjustments for:			
Income receivable from the shareholders	18	-	(1)
Gain on exchange of investment available for sale	19	-	(170)
Income from recovery of debt		(103)	(111)
Provisions / impairment losses	22	246	5
Net gain on sale of investment securities - available for sale		(88)	(57)
Net gain on sale of investment in projects and equity participations	19	(90)	(122)
Income from projects and equity participations	19	(42)	(75)
Amortisation of net premium/discount on interest bearing securities and funds		4	9
Depreciation	11	3	3
		<u>183</u>	<u>81</u>
Changes in operating assets and liabilities:			
Increase in trading securities and investments carried at fair value through income statement		(61)	(99)
Increase in other assets and other liabilities (net)		(49)	(11)
<b>Net cash inflow (outflow) from operating activities</b>		<b><u>73</u></b>	<b><u>(29)</u></b>
<b>Cash flows from investing activities:</b>			
Decrease (increase) in placements		26	(65)
(Increase) decrease in securities purchased under resale agreements	4	(172)	11
Sale and maturity of investment securities		1,273	847
Purchase of investment securities		(2,238)	(933)
(Increase) decrease in loans		(23)	13
Increase in investment in private equity funds		(3)	(48)
Sale of investment in projects and equity participations		309	156
Purchase of investment in projects and equity participations		(76)	(242)
Purchase of property and other fixed assets		(1)	(2)
Sale of interest in investment		-	53
<b>Net cash outflow from investing activities</b>		<b><u>(905)</u></b>	<b><u>(210)</u></b>
<b>Cash flows from financing activities:</b>			
Increase in deposits		775	70
Increase (decrease) in repurchase agreements	4	536	(203)
(Decrease) increase in term finance	14	(238)	546
Dividend paid	24	(236)	(177)
<b>Net cash inflow from financing activities</b>		<b><u>837</u></b>	<b><u>236</u></b>
Increase (decrease) in cash and cash equivalents		5	(3)
Cash and cash equivalents at beginning of year		4	7
<b>Cash and cash equivalents at end of year</b>		<b><u>9</u></b>	<b><u>4</u></b>

The accompanying notes form an integral part of these financial statements.

# Notes to the Financial Statements

For the year ended 31 December 2007

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## 1 INCORPORATION AND ACTIVITY

Gulf Investment Corporation G.S.C. ("the Corporation") is an investment company incorporated in the State of Kuwait on 15 November, 1983 as a Gulf Shareholding Company. It is equally owned by the governments of the six member states of the Gulf Co-operation Council ("GCC") – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The Corporation is engaged in all aspects of investment banking activities.

The Corporation is domiciled in Kuwait and its registered office is at Jaber Al Mubarak Street, Al Sharq, Kuwait.

The financial statements of the Corporation were approved and authorised for issue by the Board of Directors on 20 February 2008. The General Assembly of Shareholders has the power to amend these financial statements after issuance.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Statement of compliance

The financial statements of the Corporation have been prepared in accordance with the regulations of the government of the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets. In addition, the financial statements have been prepared in accordance with the requirements of the Kuwait Commercial Companies Law of 1960, as amended, Ministerial Order No.18 of 1990 and the Corporation's memorandum and articles of association.

### 2.2 Basis of presentation

The financial statements are prepared on a fair value basis for trading securities, financial assets at fair value through income statement, available for sale assets, derivative financial instruments and financial assets forming part of effective fair value hedging relationships, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The financial statements are presented in United States Dollars, and all values are rounded to the nearest million.

The Corporation has adopted IFRS 7 Financial Instruments: Disclosure and amendments to IAS 1 Presentation of Financial Statements effective for the year ended 31 December 2007 which has resulted in amended and additional disclosures relating to financial instruments and associated risks, capital and capital management.

The Corporation has also adopted IFRIC 9 Reassessment of embedded derivatives and IFRIC 10 Interim Financial Reporting and Impairment effective for the year ended 31 December 2007 which have had no impact on the financial position or performance of the Corporation.

The accounting policies have been consistently applied by the Corporation and are consistent with those used in the previous year.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.3 Applicable IASB Standards and Interpretations issued but not adopted

The following IASB standards and interpretations have been issued but are not yet mandatory, and have not been adopted by the Corporation:

##### *IFRS 8: Operating segments*

IFRS 8 was issued by the IASB in November 2006 and will be effective for annual periods beginning on or after 1 January 2009. Under the requirements of the standard, the Corporation would be required to disclose information used by management internally for the purpose of evaluating the performance of operating segments and allocating resources to those segments.

##### *IAS 1 Presentation of Financial Statements (Revised)*

IAS 1 Presentation of Financial Statements (Revised) was issued by IASB in September 2007 and will be effective for annual periods beginning on or after 1 January 2009. When effective, this revised standard would require disclosure of information regarding Corporation's comprehensive income that will combine all the items of income and expense recognised in the income statement together with the gains and losses on available for sale assets.

#### 2.4 Subsidiaries

Subsidiaries are those enterprises controlled by the Corporation. Control exists when the Corporation has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed during the year are included in the income statement from the date of acquisition or up to the date of disposal, as appropriate.

The subsidiaries of the Corporation are as follows:

<i>Name of Company</i>	<i>Country of incorporation</i>	<i>Effective equity interest as at 31 December 2007</i>	<i>Effective equity interest as at 31 December 2006</i>
Bituminous Products Company Limited (Bitumat)	Saudi Arabia	100%	100%
Bitumat Kuwait Company W.L.L.	Kuwait	100%	-
Gulf Denim Limited	UAE	100%	100%
Investel Holdings W.L.L.	Bahrain	100%	100%
Gulf Paramount for Electrical Services Company W.L.L.	Kuwait	92.8%	92.8%
GIC Technology Partnership Co.	Kuwait	80%	80%
Gulf Jyoti International	UAE	70%	70%
Crown Paper Mills Ltd FZC	UAE	51%	51%

The investments in subsidiary companies are not material to the financial statements of the Corporation. Accordingly, these subsidiaries are included under 'Investment in Projects and Equity Participations' (See note 10).

#### 2.5 Cash and cash equivalents

Cash and cash equivalents comprise of cash in hand, balances with Central Banks and deposits with banks with maturities of less than seven days.



## Notes to the Financial Statements

For the year ended 31 December 2007

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### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.6 Placements

Placements with banks and other financial institutions are stated at amortised cost less any amounts written off and provision for impairment.

#### 2.7 Financial Instruments

##### (i) Recognition

Regular-way purchases and sales of financial assets at fair value through income statement, trading securities, held to maturity and available for sale are recognised on trade date, the date on which the Corporation commits to purchase and sell the assets.

##### (ii) Classification

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics.

*Investments carried at fair value through income statement* are financial assets for which fair value of the investment can be reliably measured and the classification as fair value through income statement is as per the documented strategy of the Corporation.

*Trading securities* are those that the Corporation principally holds for the purpose of short-term profit taking.

*Held-to-maturity assets* are financial assets with fixed or determinable payments and fixed maturity that the Corporation has the intent and ability to hold to maturity.

*Loans and receivables* are financial assets created by the Corporation providing money to a debtor other than those created with the intention of short-term profit taking and quoted in an active market.

*Available-for-sale assets* are financial assets that are not held for trading purposes, carried at fair value through income statement, loans and receivables, or held-to-maturity.

*Derivatives* include interest rate swaps, futures, cross currency swaps, forward exchange contracts and options on interest rates and foreign currencies.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risk are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through income statement.

Issued financial instruments or their components are classified as liabilities where the substance of the contractual arrangement results in the Corporation having an obligation either to deliver cash or another financial asset to the holder.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.7 Financial Instruments (continued)

##### (iii) *Measurement*

Financial instruments are measured initially at their fair value plus in the case of financial assets not at fair value through income statement, any directly attributable incremental costs of acquisition.

Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liability when their fair value is negative. Changes in fair value of derivatives held for trading are recognised in the income statement.

The embedded derivatives separated from the host contract are carried at fair value in the trading portfolio with changes in fair value recognised in the income statement.

Subsequent to initial recognition all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses (see note 2.21).

All loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument.

After initial measurement, all non-trading financial liabilities, debt issued and other borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the effective interest rate.

##### (iv) *Fair value measurement principles*

The fair value of financial instruments is based on their quoted market price (bid price for assets) at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available then the fair value of the instrument is estimated using other valuation techniques as discussed in note 2.21.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Corporation would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current credit worthiness of the counterparties.

##### (v) *Gains and losses - subsequent measurement*

Gains and losses arising from a change in the fair value of investments available for sale are recognised directly in equity. When the financial assets are sold, collected or otherwise disposed of, or determined to be impaired, the cumulative gain or loss recognised in equity is transferred to the income statement.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.7 Financial Instruments (continued)

##### (v) *Gains and losses - subsequent measurement (continued)*

Gains and losses arising from a change in the fair value of trading instruments and investments carried at fair value through the income statement are recognised in the income statement.

##### (vi) *Offsetting*

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when the Corporation has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

##### (vii) *Derecognition*

A financial asset (in whole or in part) is derecognised either (a) when the rights to the cash flow have expired, (b) when the Corporation has transferred substantially all the risks and rewards of ownership, or (c) when it has neither transferred nor retained substantially all the risks and rewards of the assets but has transferred control over the asset or a proportion of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

##### (viii) *Impairment*

The Corporation assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired. If there is objective evidence that an impairment loss has been incurred, the loss amount is accounted for as follows:

- (a) for assets carried at amortised cost, impairment loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognised in the income statement. Subsequent decrease in impairment loss due to an event occurring after the impairment was recognised is credited to the income statement.
- (b) for equity investments available for sale, impairment represents a significant or prolonged decline in the fair value of the investment below its cost. The difference between the acquisition cost and the current fair value, less any impairment loss on the financial asset previously recognised in the income statement – is removed from equity and recognised in the income statement. Increases in fair value of equity instruments after impairment are recognised directly in equity.
- (c) for debt instruments available for sale, impairment is assessed based on the same criteria as assets carried at amortised cost. Subsequent increase in fair value of a debt instrument which is objectively related to an event occurring after the impairment loss was recognised is credited to the income statement.

In addition, in accordance with Central Bank of Kuwait instructions, the Corporation makes a minimum general provision on all applicable credit facilities (net of certain categories of collateral) that are not subject to specific provision. No other general provisions are made.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.7 Financial Instruments (continued)

##### (viii) Impairment (continued)

In March 2007, the Central Bank of Kuwait issued a circular amending the basis of making general provisions on facilities changing the rate from 2% to 1% for cash facilities and 0.5% for non cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain restricted categories of collateral, during the reporting period. The general provision in excess of the present 1% for cash facilities and 0.5% for non cash facilities would be retained as a general provision until a further directive from the Central Bank of Kuwait is issued.

#### 2.8 Repurchase and resale arrangements

The Corporation enters into purchases / sales of securities under agreements to resell / repurchase substantially identical securities at a specified date in the future at a fixed price. The amounts paid are recognised as securities purchased under resale agreements. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest method.

Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the relevant accounting policy for that investment. The proceeds from the sale of the investments are reported as part of liabilities as securities sold under repurchase agreements. The difference between the sales price and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest method.

#### 2.9 Investment in projects and equity participations

Investment in enterprises in which the Corporation has significant influence over the financial and operating policies and which are neither a subsidiary nor a joint venture ("associates") are accounted for using the equity method.

Under the equity method, the investment in associates are carried in the balance sheet at cost plus post-acquisition changes in the Corporation's share of net assets of the associates. Losses in excess of the cost of the associates are recognised when the Corporation has incurred obligations on its behalf. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The Corporation's share of the results of operations of associates is recognised in the income statement. Where there has been a change recognised directly in the equity of associates, the Corporation recognises its share of changes and discloses this, when applicable in the statement of changes in equity. Provision is made for any impairment losses and recognised in the income statement (note 2.21).

Other investments in projects and equity participations are classified as investments available for sale. Provision is made for any impairment losses on an individual investment basis and is recognised as set out in note 2.7.

## Notes to the Financial Statements

For the year ended 31 December 2007

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### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.10 Other provisions

Other provisions are recognised in the balance sheet when the Corporation has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

#### 2.11 Property and other fixed assets

Property and other fixed assets are carried at cost less accumulated depreciation and impairment losses. An impairment loss is recognised in the income statement whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of assets is the greater of their net selling price and value in use. Depreciation is computed on a straight-line basis over the estimated useful life of each asset category as follows:

Buildings	20 years
Building installations	5 - 10 years
Office equipment	3 - 4 years
Furniture	4 - 6 years
Motor vehicles	3 years

#### 2.12 Deposits

Deposits are carried at cost, less amounts repaid.

#### 2.13 Term finance

All term finance is initially recognised at fair value of consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using effective interest method.

#### 2.14 Financial guarantees

The Corporation gives financial guarantees on behalf of its associated companies. These guarantees are initially recognised in the financial statements at fair value on the date the guarantee is given, being the premium received. Subsequently the Corporation recognises its liability under each guarantee at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability is recognised in the income statement. The Corporation recognises the premium received in the income statement on a straight line basis over the life of the guarantee.

#### 2.15 Fiduciary activities

Assets managed for third parties or held in trust or in a fiduciary capacity are not treated as assets of the Corporation and accordingly are not included in these financial statements.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.16 Hedge accounting

The Corporation makes use of derivative instruments to manage exposure to interest rate, foreign currency and credit risk, including exposures arising from forecast transactions.

A hedging relationship exists where:

- at the inception of the hedge there is formal documentation of the hedge;
- the hedge is expected to be highly effective;
- the effectiveness of the hedge can be reliably measured;
- the hedge is highly effective throughout the reporting period; and
- for hedges of a forecasted transaction, the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect net profit or loss.

Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value. The treatment of any resultant gains and losses is set out below.

Where a derivative financial instrument hedges the exposure to changes in the fair value of a recognised asset or liability or firm commitment (including the foreign currency risk), the change in fair value of the hedged item attributable to the risk being hedged is recorded as part of the carrying value of the hedged item. Gains or losses on remeasurement of both the hedging instrument and the hedged item are recognised in the income statement.

Where a derivative financial instrument hedges the exposure to variability in the cash flows of recognised assets or liabilities or forecast transactions, the effective part of any gain or loss on remeasurement of the hedging instrument is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement.

When a hedged forecast transaction results in the recognition of an asset or liability, the cumulative gain or loss on the hedging instrument recognised directly in equity is removed from equity and included in the initial measurement of the asset or liability. Otherwise the cumulative gain or loss recognised in equity is transferred to the income statement at the same time that the hedged transaction affects net profit or loss and included in the same line item as the hedged transaction.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss recognised in equity remains in equity and is recognised in accordance with the above policy. If the hedged transaction is no longer expected to occur, the cumulative gain or loss recognised in equity is recognised in the income statement immediately.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is revoked by the Corporation. For hedged instrument recorded at amortised cost, using the effective interest rate method, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining life of the original hedge. If the hedged instrument is derecognised, the unamortised fair value adjustment is recognised immediately in the income statement. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

## Notes to the Financial Statements

For the year ended 31 December 2007

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### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.17 Recognition of income and expenses

##### *Interest income and expenses*

Interest income and expense is recognised as the interest accrues using the effective interest method, under which the rate used exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. Interest income includes the amortisation of any discount or premium or other difference between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

##### *Fee income*

Fees earned for providing of services over a period of time are accrued over that period. Fee income for providing transaction services are recognised on completion of the underlying transaction. Performance fees are recognised after fulfilling the criteria.

##### *Dividend income*

Dividend income is recognised when the right to receive payment is established.

#### 2.18 End of service benefits

Provision is made for amounts payable to employees under the Kuwaiti Labour Law, employee contracts and applicable labour laws in the countries where the subsidiaries operate. This liability, which is unfunded, represents the amount payable to each employee as a result of involuntary termination on the balance sheet date, and approximates the present value of the final obligation. The obligations are paid into a plan which is administrated by an independent trustee.

#### 2.19 Foreign currency

Transactions in foreign currencies are converted to US Dollars at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are converted into US Dollars at market rates of exchange prevailing on the balance sheet date. Realised and unrealised foreign exchange gains and losses are included in the income statement.

Non monetary items that are measured in terms of historical costs in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Translation gains or losses on non monetary items are included in equity as part of the fair value adjustment on securities available for sale, unless part of an effective hedging strategy. Any goodwill arising on the acquisition of a foreign operation is translated at the closing rate of exchange at the balance sheet date. Translation differences on non-monetary items at fair value through income statement are recognised in the income statement within the fair value net gain or loss.

For investments in projects and investments equity accounted, the assets and liabilities are translated into the presentation currency of the Corporation at the exchange rate ruling the balance sheet date and their income statements are translated at rates approximating average exchange rates for the year. The exchange differences arising on translation are taken directly to a separate component of equity. On disposal, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.20 Segment reporting

A segment is a distinguishable component of the Corporation that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segment income, segment expenses and segment performance include transfers between business segments and between geographical segments.

#### 2.21 Significant accounting judgements and estimates

In the process of applying the Corporation's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the financial statements:

##### ***Classification of investments***

Management decides on acquisition of a security whether it should be classified as held to maturity, held for trading, carried at fair value through income statement, or available for sale.

For those deemed to be held to maturity management ensures that the requirements of IAS 39 are met and in particular the Corporation has the intention and ability to hold these to maturity.

The Corporation classifies securities as trading if they are acquired primarily for the purpose of making a short term profit by the dealers.

Classification of investments as fair value through income statement depends on how management monitors the performance of these investments. When they are not classified as held for trading but have readily available reliable fair values and the changes in fair values are reported as part of profit or loss in the management accounts, they are classified as fair value through income statement.

All other investments are classified as available for sale.

##### ***Impairment of investments***

The Corporation treats investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Corporation evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for projects and unquoted equities.

##### ***Estimation uncertainty***

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed on the next page.



## Notes to the Financial Statements

For the year ended 31 December 2007

### 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 2.21 Significant accounting judgements and estimates (continued)

##### ***Impairment losses on loans and advances and investment in debt instruments***

The Corporation reviews its problem loans and advances and investment in debt instruments at each reporting date to assess whether a provision for impairment should be recorded in the income statement. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

##### ***Valuation of unquoted equity investments***

Valuation of unquoted equity investments is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. There are a number of securities where this estimation cannot be reliably determined and these are carried at cost as disclosed in note 10. The Corporation updates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

### 3 PLACEMENTS

As at 31 December 2007 the Corporation has no placements with non-bank financial institutions (2006: US\$ 78 million shown net of provisions amounting to US\$ 2 million).

### 4 SECURITIES PURCHASED/SOLD UNDER RESALE/REPURCHASE AGREEMENTS

(US\$ million)	2007	2006
<b>Reverse repurchase agreements</b>		
Banks	26	14
Others	160	-
	<u>186</u>	<u>14</u>

As part of the reverse repurchase agreement the Corporation has received securities that it is allowed to sell or repledge. The fair value of the securities accepted under these terms as at 31 December 2007 equals the carrying amount.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 4 SECURITIES PURCHASED/SOLD UNDER RESALE/REPURCHASE AGREEMENTS (continued)

(US\$ million)	2007	2006
<b>Repurchase agreements</b>		
Banks	1,463	898
Others	909	938
	<b>2,372</b>	<b>1,836</b>

Interest bearing securities amounting to US\$ 2,372 million (2006: US\$ 1,836 million) are pledged as security in respect of borrowings under securities sold under repurchase agreements.

### 5 INTEREST BEARING SECURITIES AND FUNDS

(US\$ million)	2007	2006
<b>Debt and other interest bearing instruments available for sale</b>		
AAA/Aaa rated debt securities	999	230
GCC Government securities	364	416
Debt securities of other investment grade issuers	2,532	2,728
Structured notes	248	110
Other debt securities	300	282
	<b>4,443</b>	<b>3,766</b>
<b>Debt and other interest bearing instruments held to maturity</b>		
AAA/Aaa rated debt securities	140	8
GCC Government securities	145	52
Debt securities of other investment grade issuers	53	65
Structured investment vehicles	209	450
Other debt securities	-	8
	<b>547</b>	<b>583</b>
<b>Trading funds</b>		
Money market enhanced liquidity funds	4	224
Bond funds	145	123
Credit funds	48	50
	<b>197</b>	<b>397</b>
<b>Total</b>	<b>5,187</b>	<b>4,746</b>

During the year an impairment loss of US\$ 139 million (2006: Nil) has been recognised on structured investment vehicles held to maturity.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 5 INTEREST BEARING SECURITIES AND FUNDS (continued)

During the year an impairment loss amounting to US\$ 101 million (2006: Nil) has been recognised in the income statement on debt and other interest bearing instruments designated as available for sale.

### 6 EQUITIES AND MANAGED FUNDS

Equities and managed funds are classified as follows:

<b>(US\$ million)</b>	<b>2007</b>	<b>2006</b>
Trading securities	431	233
Available for sale securities	295	323
Alternative equity investments carried at fair value through income statement	661	598
	<u><b>1,387</b></u>	<u><b>1,154</b></u>

Trading securities comprise investments in funds that actively trade in mortgage backed securities, managed futures, and equities issued within the GCC.

Available for sale securities comprise investments in funds that invest in equity securities, real estate securities and subordinated notes.

Alternative equity investments carried at fair value through income statement comprise investments in hedge funds and other alternative investments.

During the year an impairment loss amounting to US\$ 5 million (2006: Nil) has been recognised in the income statement on available for sale securities.

### 7 LOANS

The movements in the provision for loan losses were as follows:

#### a) Provision for loan losses

<b>(US\$ million)</b>	<b>2007</b>	<b>2006</b>
Balance at beginning of year	1	1
Transfer to general provision	(1)	-
Net charge for the year	1	-
<b>Balance at end of year</b>	<u><b>1</b></u>	<u><b>1</b></u>

#### b) Provision for loan guarantees

<b>(US\$ million)</b>	<b>2007</b>	<b>2006</b>
Balance at beginning of year	4	2
Transfer to general provision	(2)	-
Net charge for the year	2	2
<b>Balance at end of year</b>	<u><b>4</b></u>	<u><b>4</b></u>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 7 LOANS (continued)

The policy of the Corporation for calculation of the impairment provision for loans complies with the specific provision requirements of the Central Bank of Kuwait. In March 2007, the Central Bank of Kuwait issued a circular amending the basis of making general provisions on facilities changing the rate from 2% to 1% for cash facilities and 0.5% for non cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain restricted categories of collateral, during the reporting period. The general provision in excess of the present 1% for cash facilities and 0.5% for non cash facilities would be retained as a general provision until a further directive from the Central Bank of Kuwait is issued.

### 8 PRIVATE EQUITY FUNDS

<b>(US\$ million)</b>	<b>2007</b>	2006
Private equity funds	305	264
Impairment provision	-	(38)
	<u><b>305</b></u>	<u><b>226</b></u>

The following is a summary of movements in the balance of impairment provision of equity funds.

<b>(US\$ million)</b>	<b>2007</b>	2006
Balance at beginning of year	38	33
Net (reversal) charge for the year	(38)	5
<b>Balance at end of year</b>	<u><b>-</b></u>	<u><b>38</b></u>

### 9 INVESTMENT IN PROJECT HELD FOR SALE

During the year the Corporation disposed of its project held for sale for a gross cash consideration of US\$ 209 million realising a gain of US\$ 21 million in the income statement. The investment contributed income of US\$ 7 million (2006: US\$ 10 million) for the period to the date of disposal.

### 10 INVESTMENT IN PROJECTS AND EQUITY PARTICIPATIONS

<b>(US\$ million)</b>	<b>2007</b>	2006
Project investments equity accounted	494	412
Other project investments and equity participations	644	527
	<u>1,138</u>	<u>939</u>
Provision for impairment	(60)	(60)
	<u><b>1,078</b></u>	<u><b>879</b></u>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 10 INVESTMENT IN PROJECTS AND EQUITY PARTICIPATIONS (continued)

Provision for impairment relates to project investments equity accounted of US\$ 6 million (2006: US\$ 6 million) and impairment of other project investments and equity participations of US\$ 54 million (2006: US\$ 54 million).

a) Project investments equity accounted

The following table illustrates the summarised financial information of the Corporation's investments in projects equity accounted:

<b>(US\$ million)</b>	<b>2007</b>	2006
Share of assets	1,491	1,067
Share of liabilities	(997)	(655)
Share of net assets	494	412
Provision for impairment	(6)	(6)
<b>Carrying amount of investment</b>	<b>488</b>	<b>406</b>
<b>Share of profit for the year</b>	<b>36</b>	<b>55</b>

There are no material investments in project investments equity accounted listed on any public exchange.

b) Other project investments and equity participations

<b>(US\$ million)</b>	<b>2007</b>	2006
Listed investments	466	359
Unlisted investments	178	168
	<b>644</b>	<b>527</b>

Unlisted investments are carried at cost less any impairment losses, since the fair value of these investments cannot be measured reliably.

c) Provision for impairment in investments in projects and equity participations

The movement in provision for impairment is as follows:

<b>(US\$ million)</b>	<b>2007</b>	2006
Balance at beginning of year	60	60
Amounts utilised	-	(1)
Net charge for the year	-	1
<b>Balance at end of year</b>	<b>60</b>	<b>60</b>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 11 PROPERTY AND OTHER FIXED ASSETS

<b>(US\$ million)</b>			<b>2007</b>	2006
	Cost	Accumulated depreciation	<b>Net book value</b>	Net book value
Building and installations	29	(12)	17	19
Furniture, equipment and motor vehicles	11	(10)	1	1
	<b>40</b>	<b>(22)</b>	<b>18</b>	<b>20</b>

There were no significant additions or disposals during the year. The depreciation charge for the year is US\$ 3 million (2006: US\$ 3 million).

### 12 OTHER ASSETS

<b>(US\$ million)</b>	<b>2007</b>	2006
Accrued interest, fees and commissions	212	141
Derivative instruments	1	6
Employees' end of service benefit asset	43	40
Prepayments	1	1
Other, including accounts receivable	58	19
	<b>315</b>	<b>207</b>

### 13 DEPOSITS

<b>(US\$ million)</b>	<b>2007</b>	2006
Deposits from Central Banks	528	428
Deposits from other banks	1,124	834
Deposits from Islamic institutions	347	388
Other deposits	805	482
	<b>2,804</b>	<b>2,132</b>

At 31 December 2007 deposits from GCC Country Governments, Central Banks and other institutions headquartered in the GCC States amounted to US\$ 2,326 million (2006: US\$ 1,745 million).

## Notes to the Financial Statements

For the year ended 31 December 2007

### 14 TERM FINANCE

(US\$ million)	Effective interest rate % 2007	2007	2006
GIC US Dollar floating rate note due in 2007	-	-	300
US Dollar floating rate term loan due in 2010	6 months \$ LIBOR + 35 bps	200	200
<b>Medium Term Note Issues (EMTN):</b>			
GIC US Dollar floating rate note due in 2009	3 months \$ LIBOR + 55 bps	500	500
GIC US Dollar floating rate note due in 2010	3 months \$ LIBOR + 45 bps	500	500
GIC Euro floating rate note due in 2011	3 months € LIBOR + 30 bps	589	527
GIC HK Dollar floating rate note due in 2011	3 months HIBOR + 35 bps	19	19
		<u>1,808</u>	<u>2,046</u>

### 15 OTHER LIABILITIES

(US\$ million)	2007	2006
Accrued interest	108	97
Derivative instruments	11	14
Employees' end of service benefits	47	43
Other provisions	6	4
Other, including accounts payable and accrued expenses	34	30
	<u>206</u>	<u>188</u>

### 16 EQUITY

- 16.1** The authorised and issued capital comprises of 2.1 million shares of US\$ 1,000 each (2006: 2.1 million shares of US\$ 1,000 each). On 14 February 2007 the shareholders at the annual general assembly meeting approved the increase of issued and paid up capital to US\$ 1,000 million (31 December 2006: US\$ 750 million) through the capitalisation of retained earnings.
- 16.2** In accordance with the Kuwait Commercial Companies' Law and the Corporation's Articles of Association, 10 percent of the net income for the year is required to be transferred to the non-distributable compulsory reserve until the reserve reaches a minimum of 50 percent of share capital.
- 16.3** In accordance with the Corporation's Articles of Association, 10 percent of the net income for the year is required to be transferred to the voluntary reserve. The transfer to this reserve can be discontinued by a resolution adopted in the general assembly meeting of the shareholders.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 16 EQUITY (continued)

- 16.4** Investment revaluation reserve comprises the cumulative net change in the fair value of investments available for sale held by the Corporation and the Corporation's share of movements in the investment revaluation reserve of associated companies.

### 17 FINANCIAL INVESTMENTS

The table below shows the financial investments of the corporation as per IAS 39 Financial Instruments: Recognition and Measurement categorisation:

(US\$ million)

	Held to maturity	Available for sale	Fair value through income statement	Held for trading	Total
<b>31 December 2007</b>					
Interest bearing securities and funds	547	4,443	-	197	5,187
Equities and managed funds	-	295	661	431	1,387
Private equity funds	-	305	-	-	305
Investments in projects and equity participations	-	644	-	-	644
	<b>547</b>	<b>5,687</b>	<b>661</b>	<b>628</b>	<b>7,523</b>

(US\$ million)

	Held to maturity	Available for sale	Fair value through income statement	Held for trading	Total
<b>31 December 2006</b>					
Interest bearing securities and funds	583	3,766	-	397	4,746
Equities and managed funds	-	323	598	233	1,154
Private equity funds	-	226	-	-	226
Investment in project held for sale	-	198	-	-	198
Investments in projects and equity participations	-	527	-	-	527
	<b>583</b>	<b>5,040</b>	<b>598</b>	<b>630</b>	<b>6,851</b>

### 18 INTEREST AND SIMILAR INCOME

(US\$ million)

	2007	2006
Placements	56	40
Interest bearing securities and funds	250	212
Loans	2	1
Receivable from shareholders	-	1
	<b>308</b>	<b>254</b>



## Notes to the Financial Statements

For the year ended 31 December 2007

### 19 INVESTMENT AND FEE INCOME

(US\$ million)	2007	2006
Net gain on interest bearing securities and funds (see 'a' below)	3	23
Net gain on equities and managed funds (see 'b' below)	183	109
Net gain on sale of investment in projects and equity participations	68	102
Gain on exchange of investments available for sale	-	170
Income from private equity funds	86	28
Income from projects and equity participations	36	55
Income from investment in project held for sale	28	41
Profit on foreign exchange	4	1
Dividend income	22	18
Fees and commissions income (see 'c' below)	41	28
Sundry income	1	1
	<u>472</u>	<u>576</u>

Income from projects and equity participations include US\$ 32 million (2006: US\$ 62 million) relating to associated companies and US\$ 4 million (2006: US\$ (7) million) relating to subsidiary companies.

Included in net gain on sale of investment in projects and equity participations is US\$ 59 million (2006: US\$ 80 million) of realised gain on available for sale investments.

#### a) Net gain on interest bearing securities and funds

(US\$ million)	2007	2006
Realised gain on available for sale investments	14	8
Realised loss on investments held to maturity	(21)	-
Net gain from instruments held for trading	10	15
	<u>3</u>	<u>23</u>

#### b) Net gain on equities and managed funds

(US\$ million)	2007	2006
Realised gain on available for sale investments	74	49
Net gain on investments carried at fair value through income statement	64	59
Net gain from instruments held for trading	45	1
	<u>183</u>	<u>109</u>

#### c) Fees and commissions income

(US\$ million)	2007	2006
Fees from managed funds	10	12
Asset management fees	9	14
Other fees and commissions	22	2
	<u>41</u>	<u>28</u>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 20 INTEREST AND SIMILAR EXPENSES

(US\$ million)	2007	2006
Deposits	132	111
Securities sold under repurchase agreements	93	72
Term finance	107	97
	<u>332</u>	<u>280</u>

Included in interest expense is US\$ 76 million (2006: US\$ 67 million) relating to interest incurred on liabilities to fund non interest bearing assets.

### 21 INCOME FROM RECOVERY OF DEBT

The amount represents a final settlement for the recovery of debt written off in prior years.

### 22 PROVISIONS/IMPAIRMENT LOSSES

(US\$ million)	2007	2006
Placements with non-bank financial institutions(note 3)	1	-
Private equity funds (note 8)	-	(5)
Loans and loan guarantees (note 7)	(3)	(2)
Interest bearing securities and funds – held to maturity (note 5)	(139)	1
Interest bearing securities and funds – available for sale (note 5)	(101)	-
Equities and managed funds – available for sale (note 6)	(5)	-
Accounts receivable (other assets)	2	1
Other provisions	(1)	-
	<u>(246)</u>	<u>(5)</u>

### 23 RETIREMENT AND OTHER TERMINAL BENEFITS

The Corporation has defined voluntary contribution and end of service indemnity plans which cover all its employees. Contribution to the voluntary plan is based on a percentage of pensionable salary and consists of contribution by employees and a matched contribution up to a certain limit by the Corporation. Contribution to the end of service indemnity plan is based on a percentage of pensionable salary and number of years of service by the employees. The amounts to be paid as the end of service benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The Corporation also pays contributions to Government defined contribution pension plan for certain employees in accordance with the legal requirements in Kuwait.

The total cost of retirement and other end of service benefits included in staff expenses for the year ended 31 December 2007 amounted to US\$ 6 million (2006: US\$ 5 million).

### 24 DIVIDEND

The Board of Directors has recommended a dividend of 6.08% (2006: 31.5%) on paid up capital for the year ended 31 December 2007 which is US\$ 28.95 per share (2006: US\$ 112.52).

On 14 February 2007, at the annual general assembly meeting, the shareholders approved the financial statements for the year ended 31 December 2006 and the dividend proposed for that year.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT

This note presents information on the Corporation's exposure to risks arising from the use of financial instruments. The Corporation's objectives, policies and processes for measuring and managing risks are detailed in the Risk Management and BASEL II section of the annual report.

#### 25.1 Liquidity risk

Liquidity risk is the risk that the Corporation will be unable to meet its liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis.

The liquidity profile of financial liabilities reflects the projected cash flows, based on contractual repayment obligations which include future interest payments over the life of these financial liabilities. The liquidity profile of financial liabilities at 31 December was as follows:

#### 31 December 2007

(US\$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Deposits	2,582	239	-	-	2,821
Securities sold under repurchase agreements	1,938	451	-	-	2,389
Term finance	25	76	1,967	-	2,068
Derivative instruments					
- Contractual amount payable	1,199	134	-	-	1,333
- Contractual amount receivable	(1,191)	(131)	-	-	(1,322)
Other liabilities	69	64	3	12	148
<b>Total undiscounted financial liabilities</b>	<b>4,622</b>	<b>833</b>	<b>1,970</b>	<b>12</b>	<b>7,437</b>
Commitments	-	492	-	-	492
Contingent liabilities	-	270	-	-	270

#### 31 December 2006

(US\$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Deposits	1,753	271	20	103	2,147
Securities sold under repurchase agreements	1,419	428	-	-	1,847
Term finance	28	377	1,992	-	2,397
Derivative Instruments					
- Contractual amount payable	34	-	-	-	34
- Contractual amount receivable	(20)	-	-	-	(20)
Other liabilities	97	28	2	4	131
<b>Total undiscounted financial liabilities</b>	<b>3,311</b>	<b>1,104</b>	<b>2,014</b>	<b>107</b>	<b>6,536</b>
Commitments	-	143	-	-	143
Contingent liabilities	-	161	-	-	161

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.1 Liquidity risk (continued)

The asset and liability maturity profile shown in the table below is based on management's assessment of the Corporation's right and ability to liquidate these instruments based on their underlying liquidity characteristics.

(US\$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
<b>31 December 2007</b>					
<b>Assets</b>					
Cash and cash equivalents	9	-	-	-	9
Placements	502	121	-	-	623
Securities purchased under resale agreements	186	-	-	-	186
Interest bearing securities and funds	4,592	173	222	200	5,187
Equities and managed funds	1,355	10	-	22	1,387
Loans	34	6	-	-	40
Private equity funds	3	1	18	283	305
Investments in projects and equity participations	466	-	-	612	1,078
Property and other fixed assets	-	-	-	18	18
Other assets	213	55	2	45	315
<b>Total assets</b>	<b>7,360</b>	<b>366</b>	<b>242</b>	<b>1,180</b>	<b>9,148</b>
<b>Liabilities and equity</b>					
Deposits	2,570	234	-	-	2,804
Securities sold under repurchase agreements	1,930	442	-	-	2,372
Term finance	-	-	1,808	-	1,808
Other liabilities	78	66	3	59	206
Equity	-	-	-	1,958	1,958
<b>Total liabilities and equity</b>	<b>4,578</b>	<b>742</b>	<b>1,811</b>	<b>2,017</b>	<b>9,148</b>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.1 Liquidity risk (continued)

(US\$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2006					
<b>Assets</b>					
Cash and cash equivalents	4	-	-	-	4
Placements	237	411	-	-	648
Securities purchased under resale agreements	14	-	-	-	14
Interest bearing securities and funds	3,933	168	428	217	4,746
Equities and managed funds	1,084	9	-	61	1,154
Loans	1	7	9	-	17
Private equity funds	12	6	50	158	226
Investment in project held for sale	198	-	-	-	198
Investments in projects and equity participations	359	-	-	520	879
Property and other fixed assets	-	-	-	20	20
Other assets	143	20	3	41	207
<b>Total assets</b>	<b>5,985</b>	<b>621</b>	<b>490</b>	<b>1,017</b>	<b>8,113</b>
<b>Liabilities and equity</b>					
Deposits	1,747	262	19	104	2,132
Securities sold under repurchase agreements	1,413	423	-	-	1,836
Term finance	-	300	1,746	-	2,046
Other liabilities	98	41	2	47	188
Equity	-	-	-	1,911	1,911
<b>Total liabilities and equity</b>	<b>3,258</b>	<b>1,026</b>	<b>1,767</b>	<b>2,062</b>	<b>8,113</b>

#### 25.2 Market risk

Market risk arises from fluctuations in interest rates, foreign exchange rates and equity prices. The nature of these risks is as follows:

##### *Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Corporation is exposed to interest rate risk as a result of mismatches of interest rate repricing of assets and liabilities.

##### *Foreign exchange risk*

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

##### *Equity price risk*

Equity price risk arises from the change in fair values of equity investments.

The Corporation measures, monitors and manages market risk both on a notional basis, and using a Market Value at Risk (Market VaR) concept. For disclosures relating to market risk refer to the VaR table and sensitivity analysis included in the market risk analysis of the Risk Management section of the annual report, which are an integral part of the financial statements.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.3 Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Board has set limits for individual borrowers, and corporations of borrowers and for geographical and industry segments. The Corporation also monitors credit exposures, and continually assesses the creditworthiness of counterparties. In addition, the Corporation obtains security where appropriate, enters into master netting agreements and collateral arrangements with counterparties, and limits the duration of exposures.

Credit risk in respect of derivative financial instruments is limited to those with positive fair values, which are included under other assets. As a result the maximum credit risk, without taking into account the fair value of any collateral and netting agreements, is limited to the amounts on the balance sheet plus commitments to customers disclosed in note 25.

As at 31 December 2007, the Corporation has not obtained any collateral apart from reverse repurchase transactions for which the collateral obtained equals the carrying amount.

#### 25.3.1 Maximum exposure to credit risk

The maximum credit exposure of the Corporation before taking into account collateral held or any credit enhancement is as follows:

<b>(US\$ million)</b>	<b>31 December 2007 Maximum exposure</b>	31 December 2006 Maximum exposure
Cash and cash equivalents	9	4
Placements	623	648
Securities purchased under resale agreements	186	14
Interest bearing securities and funds	5,187	4,746
Loans	40	17
Other assets	315	207
<b>Credit exposure on assets</b>	<b>6,360</b>	<b>5,636</b>
<b>Credit commitments</b>	537	146
<b>Total credit exposure</b>	<b>6,897</b>	<b>5,782</b>

The net exposure after taking into account collateral and other credit enhancement is US\$ 6,711 million (2006: US\$ 5,768 million)

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Corporation's performance to developments affecting a particular industry or geographic location. The maximum credit exposure to a single counterparty (rated as investment grade) is US\$ 160 million (2006: US\$ 141 million).

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.3.1 Maximum exposure to credit risk (continued)

The Corporation's concentration of credit risk exposure by geographic region is as follows:

(US\$ million)	GCC	Other MENA	Europe	North America	Asia	Total
<b>31 December 2007</b>						
Cash and cash equivalents	5	-	2	1	1	9
Placements	611	-	12	-	-	623
Securities purchased under resale agreements	-	-	186	-	-	186
Interest bearing securities and funds	1,123	-	1,930	2,014	120	5,187
Loans	40	-	-	-	-	40
Other assets	112	-	57	144	2	315
<b>Credit exposure on assets</b>	<b>1,891</b>	<b>-</b>	<b>2,187</b>	<b>2,159</b>	<b>123</b>	<b>6,360</b>
<b>Credit commitments</b>	537	-	-	-	-	537
<b>Total credit exposure</b>	<b>2,428</b>	<b>-</b>	<b>2,187</b>	<b>2,159</b>	<b>123</b>	<b>6,897</b>

(US\$ million)	GCC	Other MENA	Europe	North America	Asia	Total
<b>31 December 2006</b>						
Cash and cash equivalents	2	-	2	-	-	4
Placements	617	-	31	-	-	648
Securities purchased under resale agreements	-	-	14	-	-	14
Interest bearing securities and funds	1,036	103	1,990	1,492	125	4,746
Loans	17	-	-	-	-	17
Other assets	63	4	50	88	2	207
<b>Credit exposure on assets</b>	<b>1,735</b>	<b>107</b>	<b>2,087</b>	<b>1,580</b>	<b>127</b>	<b>5,636</b>
<b>Credit commitments</b>	146	-	-	-	-	146
<b>Total credit exposure</b>	<b>1,881</b>	<b>107</b>	<b>2,087</b>	<b>1,580</b>	<b>127</b>	<b>5,782</b>

The Corporation's concentration of credit risk exposure by industry sector is as under:

(US\$ million)	Bank & Trading Fis.	Utilities & Mftg.	Govt. & Agencies	Other	Total
<b>31 December 2007</b>					
Cash and cash equivalents	9	-	-	-	9
Placements	623	-	-	-	623
Securities purchased under resale agreements	186	-	-	-	186
Interest bearing securities and funds	3,812	508	231	619	5,187
Loans	-	5	35	-	40
Other assets	228	68	-	9	315
<b>Credit exposure on assets</b>	<b>4,858</b>	<b>581</b>	<b>266</b>	<b>628</b>	<b>6,360</b>
<b>Credit commitments</b>	-	197	340	-	537
<b>Total credit exposure</b>	<b>4,858</b>	<b>778</b>	<b>606</b>	<b>628</b>	<b>6,897</b>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.3.1 Maximum exposure to credit risk (continued)

(US\$ million)	Bank & Trading Fls. & Mftg.	Utilities	Govt. & Agencies	Other	Total
31 December 2006					
Cash and cash equivalents	4	-	-	-	4
Placements	648	-	-	-	648
Securities purchased under resale agreements	14	-	-	-	14
Interest bearing securities and funds	3,014	883	61	788	4,746
Loans	-	13	4	-	17
Other assets	160	26	-	15	207
<b>Credit exposure on assets</b>	<b>3,840</b>	<b>922</b>	<b>65</b>	<b>803</b>	<b>6 5,636</b>
<b>Credit commitments</b>	-	69	77	-	146
<b>Total credit exposure</b>	<b>3,840</b>	<b>991</b>	<b>142</b>	<b>803</b>	<b>6 5,782</b>

#### 25.3.2 Credit quality of financial assets

In managing its portfolio, the Corporation utilises external ratings and other measures and techniques which seek to take account of all aspects of perceived risk. Credit exposures classified as 'Investment grade' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. All investment grade securities are rated by well known rating agencies. Credit exposures classified as 'Unrated' quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not 'impaired', but are not assigned any published ratings. The 'Unrated' quality includes investment in high quality GCC debt securities and unrated debt funds where the underlying is mostly investment grade.

The table below shows the credit quality by class of asset for balance sheet lines.

(US\$ million)	Neither past due nor impaired		
	investment grade	Unrated	Total
<b>31 December 2007</b>			
Cash and cash equivalents	9	-	9
Placements	623	-	623
Securities purchased under resale agreements	186	-	186
Interest bearing securities and funds	4,597	590	5,187
Loans	40	-	40
Other assets	233	82	315
<b>Credit exposure on assets</b>	<b>5,688</b>	<b>672</b>	<b>6,360</b>
<b>Credit commitments</b>	537	-	537
<b>Total credit exposure</b>	<b>6,225</b>	<b>672</b>	<b>6,897</b>



## Notes to the Financial Statements

For the year ended 31 December 2007

### 25 RISK MANAGEMENT (continued)

#### 25.3.2 Credit quality of financial assets (continued)

(US\$ million)	Neither past due nor impaired		
	investment grade	Unrated	Total
31 December 2006			
Cash and cash equivalents	4	-	4
Placements	648	-	648
Securities purchased under resale agreements	14	-	14
Interest bearing securities and funds	4,456	290	4,746
Loans	17	-	17
Other assets	179	28	207
<b>Credit exposure on assets</b>	<b>5,318</b>	<b>318</b>	<b>5,636</b>
<b>Credit commitments</b>	146	-	146
<b>Total credit exposure</b>	<b>5,464</b>	<b>318</b>	<b>5,782</b>

### 26 COMMITMENTS AND CONTINGENT LIABILITIES

In the usual course of meeting the requirements of customers, the Corporation has commitments to extend credit and provide financial guarantees and letters of credit to guarantee the performance of customers to third parties. The credit risk on these transactions is generally less than the contractual amount. The table below sets out the notional principal amounts of outstanding commitments.

<b>Credit Risk Amounts</b>	<b>2007</b>	2006
(US\$ million)	<b>Notional principal amount</b>	Notional principal amount
Transaction-related contingent items:		
- Letter of guarantees	441	92
- Shareholders deed of undertaking	51	51
Undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	45	3
	<b>537</b>	<b>146</b>

The above commitments and contingent liabilities have off balance-sheet credit risk because only origination fees and accruals for probable losses are recognised in the balance sheet until the commitments are fulfilled or expired. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows. The transaction related contingent liabilities are net of provision of US\$ 4 million (2006: US\$ 4 million).

## Notes to the Financial Statements

For the year ended 31 December 2007

### 26 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The Corporation had the following non credit commitments as at the balance sheet date:

<b>(US\$ million)</b>	<b>2007</b>	2006
Undrawn commitments for investments in private equity funds	150	138
Undrawn commitments for investments in projects and equity participations	75	20
	<u><b>225</b></u>	<u><b>158</b></u>

### 27 DERIVATIVES

Derivatives instruments are utilised by the Corporation to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management activity to hedge its own exposure to market, interest rate and currency risk.

In the case of derivative transactions, the notional principal typically does not change hands. It is simply a quantity, which is used to calculate payments. While notional principal is a volume measure used in the derivatives and foreign exchange markets, it is neither a measure of market nor credit risk. The Corporation's measure of credit exposure is the cost of replacing contracts at current market rates should the counterparty default prior to the settlement date. Credit risk amounts represent the gross unrealised gains on transactions before taking account of any collateral held or any master netting agreements in place.

#### Hedge accounting

Interest rate swaps under which the Corporation pays a fixed rate and receives a floating rate are used in fair value hedges of fixed interest securities available-for-sale.

As at the balance sheet date the notional amount of interest rate swaps used to hedge interest rate risk amounted to US\$ 2,066 million (2006: US\$ 2,188 million) and its net fair value was a swap gain of US\$ 5 million (2006: US\$ 10 million).

For the year ended 31 December 2007 the Corporation recognised a net gain of US\$ 3 million (2006: US\$ 50 million) representing the gain on hedging instruments. The corresponding loss on the hedged fixed income securities amounted to US\$ 2 million (2006: US\$ 47 million).

#### Trading activities

The table below summarises the aggregate notional amounts and net fair value of derivative financial instruments held for trading.

<b>(US\$ million)</b>	<b>Notional amounts</b>	<b>Net fair values</b>	<b>Credit risks amounts</b>
<b>31 December 2007</b>			
<i>Foreign exchange contracts:</i>			
Unmatured spot, forward and futures contracts	<b>1,328</b>	<b>6</b>	<b>9</b>
<b>(US\$ million)</b>	Notional amounts	Net fair values	Credit risks amounts
31 December 2006			
<i>Foreign exchange contracts:</i>			
Unmatured spot, forward and futures contracts	1,689	4	5

## Notes to the Financial Statements

For the year ended 31 December 2007

### 27 DERIVATIVES (continued)

#### Maturity analysis

(US\$ million)	Year 1	Year 2 to 5	Total
<b>31 December 2007</b>			
<i>Notional amounts</i>			
Foreign exchange contracts	<b>1,309</b>	<b>19</b>	<b>1,328</b>
(US\$ million)	Year 1	Year 2 to 5	Total
31 December 2006			
<i>Notional amounts</i>			
Foreign exchange contracts	1,670	19	1,689

### 28 SEGMENTAL INFORMATION

The primary segment reporting format is determined to be business segments as the Corporation's risks and rates of return are affected by differences in the products and services produced. Secondary information is reported geographically.

#### Primary Segment

For management purposes the Corporation is divided into five main business segments:

The principal investment division is responsible for actively investing in projects and equity participations.

Debt capital market segment provides a stable coupon/spread income and a reserve of additional liquidity. The investments comprise of high quality marketable debt securities diversified across a wide range of geographic and industry sectors.

Equities and alternative investments segment manages a diversified set of portfolios in an array of different asset classes and investment themes that comprise investments ranging from equities to structured finance, private equity, market neutral, hedge funds and other alternative assets.

The treasury division manages the Corporation's liquidity, short-term interest rate and foreign exchange activities using a variety of on and off-balance sheet treasury applications. The division trades on its own accounts and for clients in spot and forward foreign exchange and options, cash money markets, floating rate notes, interest rate swaps and other derivatives.

The "Corporate and other" category comprises items which are not directly attributable to specific business segments, including investments of a strategic nature, and income arising on the recharge of the Corporation's net free capital to business units. Other operations of the Corporation include asset management, operations, risk management and financial control. Transactions between business segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on rates which approximate the marginal cost of funds.

These segments are the basis on which the Corporation reports its primary segment information.

## Notes to the Financial Statements

For the year ended 31 December 2007

### 28 SEGMENTAL INFORMATION (continued)

31 December 2007 (US\$ million)	Principal investment	Debt capital markets	Equity and alternative investments	Treasury	Corporate and other	eliminations	Total
Interest and similar income	7	239	5	63	95	(101)	308
Investment and fee income	163	24	269	11	5	-	472
Interest expense and similar charges	(66)	(226)	(80)	(61)	-	101	(332)
Gross operating income	104	37	194	13	100	-	448
Other operating expenses	(12)	(7)	(2)	(3)	(28)	-	(52)
Impairment losses	(4)	(240)	(5)	1	2	-	(246)
Segment results	88	(210)	187	11	74	-	150
Income from recovery of debt							103
<b>Net income for the year</b>							<b>253</b>
<b>OTHER INFORMATION</b>							
Segment assets	1,201	5,142	1,628	1,116	61	-	<b>9,148</b>
Segment liabilities	875	4,890	1,368	57	-	-	7,190
Equity							1,958
Total liabilities and equity							<b>9,148</b>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 28 SEGMENTAL INFORMATION (continued)

31 December 2006 (US\$ million)	Principal investment	Debt capital markets	Equity and alternative investments	Treasury	Corporate and other	eliminations	Total
Interest and similar income	1	173	31	40	88	(79)	254
Investment and fee income	374	10	142	11	35	4	576
Interest expense and similar charges	(63)	(156)	(90)	(40)	(11)	80	(280)
Gross operating income	312	27	83	11	112	5	550
Other operating expenses	(6)	(3)	(2)	(2)	(38)	(5)	(56)
Impairment losses	(2)	1	(5)	-	1	-	(5)
Segment results	304	25	76	9	75	-	489
Income from recovery of debt							111
Net income for the year							<b>600</b>
OTHER INFORMATION							
Segment assets	1,139	3,891	1,878	925	280	-	8,113
Segment liabilities	717	3,714	1,741	30	-	-	6,202
Equity							1,911
Total liabilities and equity							<b>8,113</b>

## Notes to the Financial Statements

For the year ended 31 December 2007

### 28 SEGMENTAL INFORMATION (continued)

#### Secondary segment information

Although the management of the Corporation is based primarily on business segments, the Corporation operates in two geographic markets – the GCC region and International. The following table shows the distribution of the Corporation's net operating income and total assets by geographical segment:

#### 31 December 2007

(US\$ million)	GCC Region		International		Total	
	PI	Others	PI	Others	PI	Others
Gross operating income	104	104	-	240	104	344
Total assets	1,181	2,026	20	5,921	1,201	7,947

#### 31 December 2006

(US\$ million)	GCC Region		International		Total	
	PI	Others	PI	Others	PI	Others
Gross operating income	312	64	-	174	312	238
Total assets	1,120	1,859	20	5,114	1,140	6,973

### 29 FAIR VALUE INFORMATION

As at the balance sheet date the fair value of financial assets and financial liabilities that are not carried at fair value is not materially different from their carrying amounts, except for certain unlisted equity securities whose fair value cannot be reliably determined (see note 10) as there are no observable market inputs. The Corporation intends to hold these securities for the foreseeable future.

### 30 RELATED PARTY TRANSACTIONS

Related parties represent subsidiaries and associated companies, directors and key management personnel of the Corporation, and companies which they control or over which they exert significant influence. Pricing policies and terms of these transactions are approved by the Corporation's management.

There were no material transactions and balances with subsidiaries and associated companies within and at the end of the current year (2006: Nil).

#### Compensation of key management personnel

The remuneration of key management personnel during the year was as follows:

(US\$ million)	2007	2006
Short-term employee benefits	9	8
Post employment and termination benefits	1	1
Total compensation paid to key management personnel	<u>10</u>	<u>9</u>

Included in other assets are loans to key management personnel amounting to US\$ 1 million (2006: US\$ 1 million).

## Notes to the Financial Statements

For the year ended 31 December 2007

### 31 FIDUCIARY ACTIVITIES

At 31 December 2007 third party assets under management (at fair value) amounted to US\$ 639 million (2006: US\$ 492 million). These assets are managed in a fiduciary capacity and are therefore excluded from the balance sheet.

### 32 CAPITAL MANAGEMENT

The Corporation's capital represents shareholders' investment and is a key strategic resource which supports the Corporation's risk taking business activities.

The objective of the Corporation is to deploy this resource in an efficient and disciplined manner to earn competitive returns.

The Corporation manages its capital taking into account both regulatory and economic requirements.

No changes were made in the objectives, policies or processes from the previous year.

#### **Regulatory capital**

Regulatory capital consists of Tier 1 capital, which comprises of Corporation's paid up capital, disclosed reserves less goodwill.

<b>(US\$ million)</b>	<b>2007</b>	2006
Tier 1 capital	<b>1,557</b>	1,698
<b>Total Capital</b>	<b>1,557</b>	1,781
<b>Risk weighted assets</b>	<b>8,382</b>	7,107
Tier 1 capital ratio	<b>18.58%</b>	23.89%
Total capital ratio	<b>18.58%</b>	25.05%

#### **Economic capital**

The Corporation defines economic capital as the amount of capital required to cover unexpected losses arising from doing business. The Corporation determines economic capital sufficiency based on internal models.

### 33 COMPARATIVES

The Corporation has reclassified the following prior year figures to be consistent with the current year presentation and to clearly depict the nature of the instrument:

Structured notes amounting to US\$ 110 million have been reclassified from the prior year account 'Other debt securities' to 'Structured notes' under 'Interest bearing securities and funds'.

Structured investment vehicles amounting to US\$ 450 million have been reclassified from the prior year account 'Credit funds' to 'Structured investment vehicles' under 'Interest bearing securities and funds'.

# Direct Investments

(US\$ million)	Location	Total shareholders' equity	GIC share of capital %
<b>Non-consolidated subsidiaries and associated companies</b>			
Bituminous Products Company Limited (Bitumat)	Saudi Arabia	37.0	100.0
Gulf Denim Limited	UAE	5.0	100.0
Investel Holdings W.L.L.	Bahrain	56.2	100.0
G.I. Corporation General Trading & Contracting Co.	Kuwait	0.9	100.0
Gulf Paramount for Electrical Services Company WLL	Kuwait	6.1	92.8
GIC Technology Partnership Co.	Kuwait	5.2	80.0
Gulf Industrial Investment Co. (E.C.)	Bahrain	94.8	50.0
Gulf Jyoti International	UAE	5.7	70.0
Crown Paper Mill Ltd. FZC	UAE	22.0	51.0
Oman Investment Co.	Oman	28.6	50.0
United Stainless Steel Company B.S.C. (Closed)	Bahrain	80.0	50.0
Gulf Electronic Tawasul Company KSCC	Kuwait	12.6	47.5
Al Ezzel Power Company B.S.C.	Bahrain	7.2	45.0
Bahrain Industrial Pharmaceutical Co.	Bahrain	1.8	40.0
The National Titanium Dioxide Co., Ltd. (CRISTAL)	Saudi Arabia	304.7	33.0
A'Saffa Poultry Farms Co. SAOG	Oman	5.9	30.9
Jeddah Cable Company	Saudi Arabia	104.4	25.0
Kuwait International Advanced Industries Company K.S.C	Kuwait	21.6	25.0
Oman Fiber Optic Co. SAOG	Oman	14.3	25.0
Technical Supplies & Services Co. Ltd.	UAE	32.2	25.0
Interplast Company Limited - (L.L.C.)	UAE	160.9	23.5
Celtex Weaving Mills Co. Ltd.	Bahrain	6.8	23.0
Rawabi Emirates (PJSC)	UAE	73.3	22.5
Gulf Stone Company SAOG	Oman	5.8	20.0
Oman Polypropylene LLC	Oman	84.1	20.0
Shuqaiq Water and Electricity Company	Saudi Arabia	1.4	20.0
Gulf International Pipe Industry Co.	Oman	5.4	20.0
<b>Equity Participations</b>			
Tatweer Infrastructure Company (Q.S.C.C.)	Qatar	170.7	13.0
Arab Pesticide Industries Co. (MOBEED)	Saudi Arabia	1.0	12.5
Arab Qatari Co. for Dairy Production	Qatar	17.9	10.8
Gulf Ferro Alloys Company (SABAYEK)	Saudi Arabia	56.4	10.0
Ras Laffan Power Company Limited (Q.S.C.C.)	Qatar	312.9	10.0
Rasameel Structured Finance Co. K.S.C.	Kuwait	116.5	10.0
Dubai Wellness Center	UAE	81.7	10.0
Perella Weinberg Partners	USA	140.0	8.2
KGL Logistics Company K.S.C. (Closed)	Kuwait	102.9	9.0
Securities and Investment Company B.S.C.	Bahrain	92.6	7.8
National Industrialization Co. (NIC)	Saudi Arabia	1,580.0	7.9
Gulf Aluminium Rolling Mill Co. B.S.C.	Bahrain	177.1	5.9
Arabian Industrial Fibers Company (IBN RUSHD)	Saudi Arabia	140.6	4.7
Zamil Industrial Investment Co.	Saudi Arabia	237.9	2.2
United Power Company SAOG	Oman	103.9	2.3
Al-Razzi Holding Company K.S.C.	Kuwait	213.2	2.0
Thuraya Satellite Telecommunications Company PJSC	UAE	659.9	1.7
Yanbu National Petrochemical Co. (YANSAB)	Saudi Arabia	1,525.8	0.9



# Investment Products

The Fund / Currency	Inception Date	Investment Objectives
<b>GCC Funds</b>		
1 Gulf Premier Fund / US\$	April 2003	<ul style="list-style-type: none"> <li>• Attain capital appreciation through investments in GCC equity markets.</li> <li>• Achieve competitive returns against a GCC equities index.</li> </ul>
2 Protected Gulf Premier Notes / US\$	December 2005	<ul style="list-style-type: none"> <li>• Provide safe access vehicle to the growing GCC equity through a capital guaranteed notes on Gulf Premier Fundmarkets.</li> </ul>
3 Gulf Bond Fund / US\$	March 2005	<ul style="list-style-type: none"> <li>• Maximize income returns through investments in debt issues of GCC entities.</li> <li>• Preservation of capital and lower volatility of total returns.</li> </ul>
4 GIC KD Bond Fund / KD	May 2003	<ul style="list-style-type: none"> <li>• Maximize current income and price appreciation consistent with preservation of capital and lower volatility through investment in debt issues in Kuwaiti markets.</li> </ul>
<b>Global Funds</b>		
1 Alternative Strategies Fund / US\$	August 1999	<ul style="list-style-type: none"> <li>• The fund is a portfolio of hedge funds that is diversified across a broad mix of styles and strategies that seek to generate longterm capital appreciation while maintaining a low correlation with traditional global financial markets.</li> <li>• Risk Objective: Less volatile than traditional equity investments, emphasizing preservation of capital in down markets.</li> <li>• Achieve annual total returns in the range of LIBOR plus 3% to 5%.</li> </ul>
2 GIC Event-Driven Fund / US\$	July 2002	<ul style="list-style-type: none"> <li>• Provide returns with low volatility 2%-4%.</li> <li>• A fund of hedge funds focused on event-driven hedge fund strategies.</li> <li>• Absolute annual returns in the range of LIBOR plus 4% to 8%.</li> <li>• Achieve those returns within volatility of 3% to 5%.</li> <li>• Provide returns with low correlation to the general direction of the traditional equity, fixed income and credit markets.</li> </ul>
3 GIC Global REITS Fund / US\$	December 2005	<ul style="list-style-type: none"> <li>• Deliver capital appreciation through investments in global Real Estate securities listed in US, Europe and Asian equity markets.</li> </ul>
4 Khaleej II CDO / US\$	November 2005	<ul style="list-style-type: none"> <li>• Achieve competitive and stable returns.</li> <li>• The first managed CDO using the "pay-as-you-go" credit default swap of grade ABS.</li> <li>• Achieve income and stability of returns.</li> <li>• Provide an IRR of 10.5% per annum for subordinated note holders.</li> <li>• Quarterly distributions.</li> </ul>



# Corporate Directory

## Senior Management

Chief Executive Officer & General Manager

**Hisham Abdulrazzaq Al-Razuqi**

Deputy General Manager  
& Head of Finance & Administration

**Rashid Bin Rasheed**

## Global Markets

Head of Global Markets Group

**Riccardo Ricciardi**

Head of Debt Capital Markets

**Abdulaziz Al-Mulla**

Funding & Liquidity

**Martin Joy**

Money Markets

**Mathew Abraham**

Head of Business Development

**Malek Al-Ajeel**

Managed Funds

**Fahmi Al-Ali (Acting)**

Head of GCC Equities

**Talal Al-Tawari**

GCC Fund Management

**Waleed Al-Braikan**

Head of GCC Research Division

**Tarek El Rohayem**

## Principal Investing

Head of Utilities and Financial Services

**Shafic Ali**

Head of Manufacturing Projects

**Khaled Al-Qadeeri**

Head of GCC Diversified Projects

**Mohammad Al-Melhem**

Head of Investment Banking

**Ross Howard**

Head of Project Finance

**Robert Montgomery**

## Finance & Administration

Head of Information Technology

**Hani Al-Shakhs**

Head of Financial Control

**Hazem El-Rafie**

Head of Operations

**Shawki Khalaf**

Acting Head of Human Resources & Administration

**Fahad Al-Abdulkader**

Manager-Communication & Public Relations

**Khaled Al-Suraye**

## Corporate Office

Head of Economics & Strategy

**Dr. Soliman Demir**

Head of Risk Management

**Nabil Guirguis**

Head of Internal Audit

**Hamdy El-Sayed**

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### **The Society of Six**

Gulf Investment Corporation is a society. An organized group of countries from the Gulf Cooperation Council namely Kuwait, United Arab Emirates, Kingdom of Saudi Arabia, Kingdom of Bahrain, Qatar and Oman, that share an interest of growth and success for each respective community.

GIC is a structured community of different GCC countries which is bound by its people of different traditions, institutions and nationality.

GIC as a society forms a symbiotic relationship to its community and to its employee, from the top hierarchy down to its most humble employee, likewise sharing GIC's future vision.